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Politics this week

May 8th 2003
From The Economist print edition

The man for the job

Paul Bremer, a former head of counter-terrorism at the State Department, has been appointed by George Bush to be the top civil administrator in Iraq. Mr Bremer will select the new Iraqi interim administration. Jay Garner, a retired general and the Defence Department's choice, will continue to work on Iraq's reconstruction but report to Mr Bremer.

See article: The shadow of change

A sharp rise in **cholera** cases in Basra, where water supplies are still disrupted, has led the World Health Organisation to give warning of a possible epidemic in southern Iraq.

AFP

See article: Postwar Iraq

The *Sydney Morning Herald*, an Australian newspaper, published an audio tape purportedly by **Saddam Hussein**, in which the tired-sounding ex-president, or his stand-in, urges Iraqis to wage an underground war against the Americans and British.

Colin Powell, America's secretary of state, announced plans to visit **Berlin**: a step towards re-establishing Iraq-torn relations with Gerhard Schröder's government. But the Pentagon, by asking Poland to play a prominent peacekeeping role in Iraq, seemed keener on strengthening ties with the “new Europeans”.

See article: Poland, “Old Europe” and the United States

Labour's loss

The head of Israel's Labour Party, **Amram Mitzna**, resigned. A retired general and an advocate of peace talks with the Palestinians, Mr Mitzna had been under pressure from his party for his refusal to join Ariel Sharon's hardline coalition.

See article: Time for action

Algeria's president, Abdelaziz Bouteflika, sacked his prime minister, **Ali Benflis**, replacing him with a former prime minister, Ahmed Ouyahia. Mr Benflis had apparently urged more conciliatory measures, including talks with the Islamists and Berbers, than Mr Bouteflika or the army would countenance.

Zimbabwe's Supreme Court struck down the provisions in a tough new media law that dealt with publishing “falsehoods”. More than a dozen journalists have been charged under these provisions, which are now ruled unconstitutional and invalid. However, a new version of the law is being submitted to parliament.

Walter Sisulu, a hero of the anti-apartheid movement and mentor to Nelson Mandela, died aged 90.

See article: Walter Sisulu

Efforts to form a transitional government in **Congo** advanced when the largest rebel group, the

Rwandan-backed RCD-Goma, named its secretary-general to be one of the four vice-presidents. The government and the second largest rebel group, the Ugandan-backed MLC, have already appointed representatives; the political opposition has not.

Flood waters rise

AFP

At least 23 people died, 1,700 were said to be missing and 35,000 were evacuated after the worst flooding in 500 years in Santa Fe province in **Argentina**. Some 1.5 metres of rain, nearly twice the annual average, fell in two days.

Ten hostages held by **Colombia's** FARC guerrillas, including a departmental governor and a former defence minister, were killed during an army rescue attempt. The FARC claimed they died in crossfire; three survivors said their fellow captives were executed before the troops arrived.

See article: New victims of Colombia's conflicts

Setbacks for human-rights campaigners in **Guatemala**: an appeals-court judge freed a retired army colonel jailed for the murder of an anthropologist in 1990. And hundreds of former paramilitary fighters rioted, demanding that the government raise a compensation offer for their role in hunting down leftist guerrillas during the country's civil war.

Local difficulties

Britain's Labour government suffered poor local-election results but easily survived a revolt by “old Labour” MPs against plans to give some hospitals limited autonomy: a two-tier national health service, cried its critics.

See article: Health service reforms

Italy's prime minister, **Silvio Berlusconi**, appeared at a trial where he is accused of bribing judges over the sale of a state-owned food company in the 1980s. Though he did not buy the firm, he did a public service, he said: he foiled an attempt by the state holding company to sell the food firm far too cheaply.

See article: Italy's forthcoming EU presidency

Spain's opposition Socialist Party proposed wide democratic reforms: no list of candidates to include more than 60% of either sex; a right for the voter to choose between candidates on the list; directly elected mayors; stronger parliamentary oversight of government spending and actions; and more.

Runners get set

Dick Cheney said that George Bush has asked him to run as **vice-president** on the ticket in 2004, and he had accepted. Meanwhile, Senator Bob Graham entered the Democratic presidential race, but Gary Hart, a previous contender, said that he would not run.

Mitch Daniels, the White House **budget director**, resigned. He is likely to run for governor in Indiana.

AP

New Hampshire's best known landmark, the Old Man of the Mountain, a lofty rock that looked like a man's face, collapsed into rubble.

An investigation into the break up of the **space shuttle** *Columbia* concluded that the disaster happened after superheated gas entered through a small hole in the front edge of the left wing. So far, it seems that the hole was caused by a piece of insulation foam striking the wing after take-off.

Spreading SARS

China, the source of the deadly SARS outbreak, reported that the number of known cases had risen to 4,560, with 219 deaths. The government said it was worried about the spread of the virus to rural areas, where medical services are weak. Some villages have set up roadblocks to keep out visitors from Beijing and other towns.

See article: China steps up the fight

Richard Armitage, America's deputy secretary of state, visited India and Pakistan, hoping to encourage peace moves over **Kashmir**. But violence continued in the divided state, with at least 20 people killed in clashes.

See article: India, Pakistan and Kashmir

Indonesia was poised to send troops in to **Aceh**, its westernmost province, to disarm separatist rebels after a peace deal, signed in December, broke down.

See article: Indonesia's unmanageable provinces

The United States told **Thailand** of its “serious concerns” about the high death toll in its war on drugs. Thailand declared “victory” at the end of a three-month campaign in which 1,612 dealers died.

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Business this week

May 8th 2003
From The Economist print edition

An echo of the boom

In a deal reminiscent of the dotcom boom years, Barry Diller's **USA Interactive** acquired **LendingTree**, an online financial-services website, for shares worth over $700m. Dissimilarities to the internet's heyday: revenues—and even profits.

See article: A dotcom revival?

Despite the slump in technology spending, **Cisco Systems** reported profits of $987m in the quarter to April, up 35% on a year ago after aggressive cost cutting. The internet-equipment firm was cautious about the outlook for the market.

Dell Computer is to ask shareholders to approve a name change. The world's top PC maker wants to delete “Computer” to avoid suggesting a narrow focus, as it makes servers and similar devices.

Ted Turner celebrated his impending retirement as a vice-president of AOL Time Warner by selling over half his stake in the world's leading media company for $784m.

Haim Saban, an American media mogul who is paying *euro*525m ($596m) for 72% of **ProSiebenSat.1**, reportedly asked Germany's stockmarket regulator to exempt him from a mandatory offer for the rest of the country's largest broadcaster, saying that the firm needs restructuring. Other investors were not amused.

Volkswagen made profits of *euro*202m ($217m) in the first quarter, 68% down on a year ago. The German firm's new boss, Bernd Pischetsrieder, is sweeping all the bad news out of the way in his first year. VW's ills include a strong euro and ageing products.

Solvency protection

US Airways showed the airline industry how to make a profit: go bankrupt and re-emerge as a privately owned company. Jettisoning debt on aircraft leases and losing the pilots' pension scheme contributed to first-quarter profits of $1.6 billion. Excluding these exceptional gains, the airline suffered a loss of $282m.

EasyJet, Europe's biggest low-cost airline, reported a bigger-than-usual loss in the half year to March; it cut low fares even lower to fill seats. The airline's problems include buying a rival carrier, Go, for more than it was worth.

The SARS virus added to **Cathay Pacific's** ills. The Hong Kong airline asked staff to take unpaid leave as passenger numbers plunged by 75% compared with a year ago. **Qantas's** condition worsened. The Australian airline issued a second profits warning in six weeks after cutting international flights by 20% in March.

Ahold, a troubled Dutch grocery group, says that its American Foodservice unit overstated earnings by 76% during the past three years. Ahold fired two executives.

Banks buck up

BNP Paribas topped forecasts by making *euro*962m ($1.0 billion) in the first quarter, but the French bank's profits were down 5.6% compared with a year ago. **Credit Suisse** returned to profit. The Swiss bank made SFr652m ($477m) in the quarter after a dismal performance last year forced heavy cost cutting and thousands of lay-offs.

Commerzbank made a slim profit of *euro*3m ($3.2m) in the first quarter, exceeding analysts' expectations. Germany's fourth-largest bank predicted a return to profit this year after suffering its first-ever annual loss in 2002.

Unfair trade

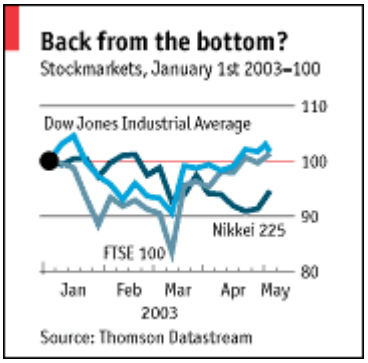
The EU issued a stark ultimatum and a September deadline to America: repeal "**foreign sales corporations**", tax-avoidance vehicles that act as export subsidies, or suffer sanctions worth $4 billion. The perk for big American exporters was ruled illegal by the WTO in 2000.

America's **Federal Reserve** left interest rates unchanged. It expects the end of the war in Iraq to push down oil prices, lift consumer confidence and hearten markets. But it gave a warning about the "minor probability" of deflation while growth is weak. The **European Central Bank** also left interest rates unchanged.

See article: Struggling to get the balance right

EM.TV, a German media group, agreed to sell the **Jim Henson Company**, which owns the Muppets, back to Henson's heirs for $89m—a fraction of what it paid for Kermit and Miss Piggy three years ago.

Stockmarkets in America and Europe continued to rally as investors put aside fears of sluggish economic recovery. The Dow Jones Industrial Average has gained some 13% since a mid-March low and Britain's FTSE 100 topped 4,000 for the first time since January. Even Japan's ailing Nikkei 225 perked up a bit.



North Korea's government issued bonds for the first time since 1953, possibly signalling a limited embrace of capitalism. Take-up of "People's Life Bonds" was said to be brisk but, undermining the spirit of the free market, not voluntary.

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Pensions

How's your pension doing?

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Companies should not get tax breaks to provide their workers' pensions

OLD age used to be a time of poverty. When people could no longer earn, they had to rely on their family to care for them. Then in the 1880s along came Germany's Otto von Bismarck with the splendid notion that the state should provide pensions. More or less at the same time, some paternalist employers began to provide for their workers' retirement. However unpleasant it might be from other points of view, ageing appeared to be less financially risky.

Now, the risk is returning. The basic problem is familiar: as people live longer and the proportion of workers in the population stops rising, the cost of caring for the old eats up a growing portion of national income. Government-financed pensions are paid by taxpayers when they fall due. In Italy the state pensions bill now runs at an astonishing 14% of the country's GDP. Many governments would like companies to carry more of that burden. But the collapse of financial markets has left most corporate pension funds with assets that fall far short of their increasing liabilities (see article). The time has come for governments to stop trying to bribe companies to assume a role that rightly belongs to the individual and the state.

In America and Britain, where the pension burden has been shifted furthest to the private sector, the state of corporate schemes is enough to turn an accountant's hair grey overnight. Some companies' earnings will be reduced by a quarter this year because of the hole in their pension fund. HSBC, an investment bank, estimated in a report on May 5th that the pension shortfall of companies in the S&P100is now as much as $340 billion. In Britain, one recent study found that the pre-tax deficits of seven firms, including those of British Airways and Rolls Royce, are equal to more than half their market capitalisation.

Inefficient and unfair

The history of corporate pensions has not been a satisfactory one, even before the stockmarket collapse wreaked such havoc. Encouraged by tax deductions and regulation, half of all American companies with pension plans and many British ones offer their staff “defined-benefit” schemes, which pay pensions linked to an employee's final salary. Such schemes neatly fitted the lives of men who worked for the same company all their lives. Once women began to work, typically part-time, and once employees began to switch jobs, defined-benefit schemes became inequitable. Those who worked full-time, stayed put and got promoted late in their careers got a subsidy from their more itchy-footed colleagues. Legislation eventually righted some of those wrongs, but defined-benefit schemes are not well suited to the pattern of many people's lives. However, workers seem to like them, and for good reason: because they promise a certain level of pension, companies rather than employees carry the main risk.

Until recently, defined-benefit plans were popular with employers too. During the good years of booming equity markets and low inflation, such schemes did so well that some companies, such as Shell and Philips, made a profit with their workers' pension arrangements. Because their funds' assets far exceeded their liabilities, the companies took money out of their pension plans. Now most companies wish they had never taken on the pension business in the first place. More and more (including *The Economist*) have shut their defined-benefit plans to new entrants. They are replacing them with defined-contribution plans, savings schemes into which employees and employers put regular contributions.

These are surely a better option. For companies, defined-benefit schemes force an impossible choice. If they put in too much money, to guard against problems like those of today, the fund becomes a sort of capital sump, locking up cash that the business might have used for the benefit of shareholders and current employees. If they put in too little, they eventually have to choose between cutting rewards to shareholders and employees or breaking their pledges to their former staff. The guarantee implied in a typical defined-benefit scheme is not the sort of risk that a company should be expected to incur.

The bucks stop here

Judging the right provision for old age is surely the individual's job, not that of his boss. If a company and its staff agree to defer some pay and put it into a savings account, then nobody should object. Ideally, workers should have a choice. They could join a savings plan sponsored by their company, which might choose selected investment vehicles and enjoy the economies of scale that come with pooling savings with other employees. Or they could just take higher pay and set off on their own. America's 401 (k) scheme, home to the savings of some 52m Americans, allows employees to make voluntary contributions that are generally half-matched by employers. Such savings accounts are the right way to save for old age. But, to create such choice, corporate tax breaks for employer contributions must go. Governments should give tax relief on income that is saved for old age—and, indeed, on all savings. But the relief should go to the individual and not (as with employers' contributions to the 401(k) scheme), to the employer.

Some may object that people cannot be trusted to save the right amount to retire on, and so companies need to step in. But companies may abuse their role: in America, many companies stuffed their employees' pension accounts with their own stock (a bad idea, if your employer is Enron); and others have cut or stopped their contributions when times turned sour. If people are indeed feckless, then the task of ensuring that they put aside part of their pay should fall not to companies but to government. To a tax-financed safety net to protect the old from poverty, governments can always add a legal obligation to save a certain proportion of annual income.

Providing for old age will always be risky. The risk may fall on a government which may renege on its predecessors' promises, or on a company that may welch on its contributions, or on a money-manager who may deliver rotten returns. Increasingly, individuals will have to decide how to invest their savings. It won't be easy, but then it never really was.

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Information technology

Less is Moore

May 8th 2003
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Moore's law may be running out of steam

AP

WHEN Gordon Moore, the 74-year-old co-founder of Intel, a chipmaker, gave a speech recently at a conference in San Francisco, there were standing ovations and fans asking for autographs. The rock-star treatment was well deserved. For, in the early days of computing, Mr Moore spotted a principle: the number of transistors on a silicon chip would double roughly every 18 months. Moore's law is not a law in the physical sense, but it has proved broadly accurate: between 1971 and 2001, transistor density has doubled every 1.96 years. In consequence, chips (and thus computers, networks, and storage devices) have become incredibly cheap and powerful.

However, as Mr Moore himself observes, “no exponential is forever.” Moore's law may be good for at least another decade (see article for the latest improvement in computer-memory technology), but eventually chips will get faster more slowly. For one thing, the improvement of chips now faces serious technical challenges. The more densely transistors are packed, the hotter they get. Intel's chips will soon reach the energy density (meaning watts per square centimetre) of a nuclear reactor. Most people do not want a small nuclear reactor on their laps: it will not cause computers to melt down, but laptops have already inflicted nasty burns. Engineers will doubtless solve such problems. But it is not just the power of chips that has grown exponentially. So has the cost of developing and manufacturing them. This mattered little while improvements in chips brought equally useful gains. Now, though, chips are becoming good enough for most applications. So chip makers can no longer rely on the cheerful old principle of “Build it and they will come.”

That is unlikely to be a catastrophe for the industry. Instead, a bit less fixation on raw technology may bring benefits. It will give the industry space to concentrate on what increasingly matters to customers: not the speed of improvements in chips, but things such as the reliability and user-friendliness of computer systems.

Now, think of the customer

More often than not, computer systems are still unreliable, insecure and hard to integrate. Enterprise software has a particularly bad track record: many studies show that more than half of IT projects are considered failures—because they fail to deliver the promised business benefits. Not many customers laughed when Larry Ellison, chief executive of Oracle, the world's second-largest software firm, said: “We became the largest industry in the world by selling things that people didn't want to buy.”

Instead of stuffing more technology down its customers' throats, the IT industry must help them to use its wares to become more productive. That might be termed Google's law, after the popular web-search engine that owes much of its success to concentrating on its users. To some extent this change is under way (see our survey). IBM already looks more like a huge business consultancy than a technology giant. There is much scope: unlike earlier boom technologies, such as the railways, IT has the capacity to alter almost every corporate activity. That will require rethinking basic business principles. But there is still a long way to go. Unless the industry focuses less on Moore's law and more on Google's law, it will become a commodity business. For this, nobody will get standing ovations: not even Mr Moore.

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Silvio Berlusconi

Unfit to lead Europe

May 8th 2003
From The Economist print edition

The Italian prime minister is not the man to speak for the European Union

Get article background

EPA

ON JULY 1st, Italy becomes president of the European Union. It is a six-monthly handing over of the baton that elicits no excitement at all in normal circumstances, but these days the circumstances are not quite normal. Politically, Europe is split. Economically, it is sputtering. The war in Iraq has lacerated relations with its main ally, the United States. Ten newcomers are about to join the club and, if the expanded Union is not to find itself paralysed, agreement must be reached on a new constitution. It is plainly time for clear-sightedness, diplomatic finesse and the exercise of the sort of moral authority that comes with ungrudging respect. Can Italy offer such leadership? Or, rather, can its prime minister, Silvio Berlusconi?

Our answer is no. Two years ago, when Mr Berlusconi was campaigning for the Italian prime ministership, we explained why we thought he was unfit for that job. We argued that, in addition to the many conflicts of interest between his own businesses and the affairs of state that would arise were he to be elected, he also had a compelling case to answer on a string of grave charges. Though Italy's highest criminal court has not definitively convicted him on any of those charges, he has yet to lay to rest all the concerns about his probity.

One reason for that is the manner in which the cases against Mr Berlusconi have been concluded. Most have owed less to clear-cut acquittals based on the evidence than to Italy's statute of limitations, or to recent changes in legislation apparently designed to benefit the prime minister as a defendant. These changes, pushed through a parliament dominated by a pro-Berlusconi majority, have included a law on judicial co-operation with foreign jurisdictions (with implications for at least one case against Mr Berlusconi), a measure to reduce the seriousness of some types of false accounting by making them civil rather than criminal offences (another three cases), and a law to let defendants seek to have their trials moved to another jurisdiction if they have a “legitimate suspicion” that the court handling their case may be biased (which could be used to spin out a trial and thus to help defendants benefit from a statute of limitations). This last law was unsuccessfully invoked by Mr Berlusconi in the one criminal case that is still outstanding, which explains why he was in court this week denying accusations of bribing judges back in 1985.

The allure of immunity

That trial will continue for several months, well into the Italian presidency of the EU and raising the possibility, on the basis of this week's form, that it will become a battleground between the current prime minister and one of his predecessors, Romano Prodi, who is now president of the European Commission. But Mr Berlusconi's allies seem to be more worried about the possibility of a guilty verdict. Last week one of his closest friends and political allies, Cesare Previti, was sentenced to 11 years in jail for corruption. Now there is talk of parliament's passing a law to grant immunity from criminal prosecution to those with “high state roles”. Such a law might ease the discomfiture of Mr Berlusconi's supporters at home. It would do nothing for his wider reputation abroad.

Instead, parliament might usefully be turning its attention to Mr Berlusconi's conflicts of interest. These

have been a real or potential embarrassment since before his first prime ministership nine years ago, and it seemed incredible that simple decency had not ensured a resolution by the 2001 election. But Mr Berlusconi seems to find it hard to distinguish between propriety and proprietor. Nearly two years after taking office for the second time, a promised law to tackle his conflicts of interest has yet to be enacted. In the meantime, though Mr Berlusconi exercises huge influence over the state broadcaster, RAI, his family has yet to divest itself of Italy's three largest private television channels.

Mr Berlusconi says he is the victim of a communist plot (*The Economist*, which he is suing for libel, is apparently a part of it), and the judiciary is biased against him. Some Italian magistrates are no doubt left-wingers; it would be odd if that were not so, in a country in which political partisanship has long permeated almost every public institution. But Italy also has right-wing magistrates, and in any event it is possible to hold political views and yet dispense impartial justice. If Mr Berlusconi is indeed the victim of a plot, he needs to show the world his evidence. The proper way to do that, for a man in his position, is to step down from his public post and defend himself in court. If and when he has fully cleared his name, Europeans may feel easier about having him speak for Europe.

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Getting warmer

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But without progress on Kashmir, the good news won't last

AP

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WHEN it comes to the vexed trinity of India, Pakistan and Kashmir, things are often the opposite of how they seem. In December 2001, for instance, it looked to much of the world as though the two nuclear powers were at the brink of war. In response to an attack on its parliament building in Delhi, India massed hundreds of thousands of troops along its border with Pakistan. In fact, senior Indian politicians now admit in private, war was never seriously contemplated. The threat of Armageddon, though, had its uses. It concentrated minds, America's included. Pakistan's president, Pervez Musharraf, was pressed hard to crack down—though he did it only partially—on the Islamic groups that carry out violent attacks in Indian-controlled Kashmir and that his government shelters. Now, however, there is a danger of what stockbrokers would call overshoot in the opposite, more optimistic, direction.

To general relief, India and Pakistan have agreed to re-establish full diplomatic relations (see article). There is less to this than meets the eye: until February, relations were being conducted efficiently enough, at deputy-ambassador level, before a rather juvenile row led to a round of expulsions. Potentially much more important is the stated desire of both sides to resume talks over the issues in dispute between them, including Kashmir. There has been no summit meeting between the two countries since General Musharraf and India's prime minister, Atal Behari Vajpayee, met, disastrously, at Agra in July 2001. Also welcome is an apparent agreement to re-open air links between South Asia's two largest countries, severed since the Delhi attack.

The presence in the region this week of Richard Armitage, America's deputy secretary of state, further encourages the view that some sort of co-ordinated rapprochement is under way. But the danger is that this, like every other India-Pakistan initiative, will founder on the rock that is Kashmir. On this issue, there is no real change to be discerned on either side.

Unbalanced

The asymmetry that bedevils the entire process is that India already has pretty much what it wants. It controls all but a miserable sliver of Kashmir, and it faces no security threat there that it cannot contain—at a price, but one paid mainly in Kashmiri blood. After holding a relatively successful election in Kashmir last year, India believes that its campaign to win hearts and minds, in Kashmir and abroad, is slowly succeeding.

For Pakistan, the position is much more difficult. Kashmir, with its Muslim majority, is integral to the country's view of itself: one version of the derivation of the very name Pakistan is that the K in it stands for Kashmir. For many years, the essence of Pakistan's foreign policy was to bleed India in Kashmir, while securing a friendly neighbour on its other flank, in Afghanistan. Encouraging a network of Islamic jihadists was the method employed to attain both goals. Forced to choose sides in the global war on terrorism after the September 11th attacks, Pakistan abandoned this strategy in Afghanistan. But there is no convincing sign yet that General Musharraf is brave enough to carry through what would be seen by many in Pakistan as a second betrayal, this time in Kashmir.

India's leaders feel badly let down by General Musharraf, who has repeatedly promised to end cross-border terrorism and close down extremist religious groups. Mr Vajpayee is reluctant to commit himself to another summit meeting until more of this ground-work has been laid. And he has again refused to involve third parties—a rebuff to Pakistan, which insists that Kashmiris be involved too. There can be no concessions, he says, until Pakistan keeps its promise on terrorism.

Here is where America can help. While the war in Afghanistan was still going on, America could not afford to push General Musharraf too hard. But that war has now ended. For many months, critics have been sniping at the Bush administration's unsavoury choice of ally. There is growing evidence, too, that Pakistan helped North Korea develop secret uranium-enrichment technology for its nuclear programme, and may also have helped Iran. Mr Armitage had the opportunity this week to apply considerably more of a squeeze on Pakistan than General Musharraf has experienced of late. September 11th turned him overnight from pariah to America's ally, but Pakistan's own actions could yet reverse that transition. If the fight against terrorism is to mean anything, Pakistan must be forced to renounce it too.

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Prisoners in Guantanamo

A place in the sun, beyond the law

May 8th 2003
From The Economist print edition

America's prison camp at Guantanamo Bay should be dismantled

Reuters

IS THE United States government reconsidering its controversial detention of more than 650 prisoners at an American naval base at Guantanamo Bay in Cuba? As so often with the Bush administration, the signals are mixed. This week, officials said that they are preparing to release more than a dozen prisoners held there. The move comes after Colin Powell, America's secretary of state, reportedly sent a strongly worded letter to Donald Rumsfeld, the defence secretary, noting that he was receiving constant complaints from many of the 42 nations (including some of America's closest allies) whose citizens are being held in Guantanamo. Despite this, officials at the Pentagon insist that the forthcoming releases are not in response to international pressure.

As if to drive the point home, they have also said that up to 30 new prisoners are due to arrive soon at Guantanamo. America seems to have no plans to shut the prison, or to alter significantly how it deals with the people held there. The administration should think again. America's handling of the prisoners at Guantanamo is wrong in principle, and a tactical error in its broader fight against terrorism.

Any criticism of America's policy should recognise that, in the wake of the September 11th attacks, it faced genuine dilemmas. The attacks were so devastating that they seemed like acts of war rather than ordinary mass murder or run-of-the-mill terrorism. Also, al-Qaeda operates entirely outside the bounds of any rules or civilised constraints. Defeating such a ruthless terrorist conspiracy may well require special rules. And America's initial emphasis on gathering information from suspects to fend off further attacks, rather than bringing them to trial, was understandable.

Yet the camp at Guantanamo represents something more than urgency or security. Held on a perpetual lease from Cuba, which has no control over the base, it was chosen deliberately as a legal loophole. Those imprisoned there, the Bush administration has argued, are beyond the reach of any court, and so effectively beyond the law. They have no rights.

The Geneva Conventions, the administration says, do not apply to the Guantanamo prisoners. The captives can be held indefinitely, without access to a lawyer or even, if American authorities so decide, to consular officials from their own country. After 16 months, none of those detained at the camp has been charged. But if any prisoners are ever brought to trial, it will be before a military commission chosen by the Pentagon, which can hold its proceedings in secret and, if it chooses, condemn prisoners to death with no right of appeal to any civilian judge aside from the president himself, who would have made the decision to put them on trial in the first place.

This claim that America is free do whatever it wishes with the Guantanamo prisoners is unworthy of a nation which has cherished the rule of law from its very birth, and represents a more extreme approach than it has taken even during periods of all-out war. It has alienated many other governments at a time when the effort to defeat terrorism requires more international co-operation in law enforcement than ever before. America's casual brushing aside of the Geneva Conventions, which require at least a review of each prisoner's status by an independent tribunal, made America's invocation of these same conventions on behalf of its own soldiers during the recent Iraq conflict sound hypocritical.

Retreating from legal limbo

America has had plenty of time to gather information from Guantanamo's inmates. It should now release those who pose no danger and promptly bring criminal charges against those who do. In putting them on trial, it has a number of options.

The best choice remains the civilian courts, despite the obvious risks. America is already trying one al-Qaeda member in federal court, and another has been convicted in a German civilian court. But if American authorities feel that, for reasons of security, special tribunals are required, then these should be run by truly independent judges, according to fair rules, and defendants must be able to appeal against conviction.

The Guantanamo prison itself should be dismantled. It symbolises a legal limbo into which no law-abiding society should ever willingly stray. Even those accused of terrorism have rights, however egregious their alleged crimes.

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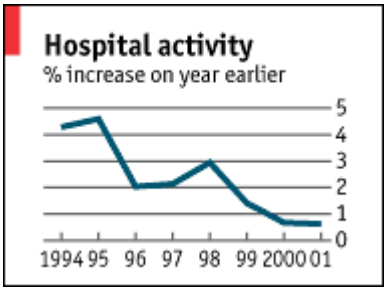
National Health Service

Big end, little end or thin end?

May 8th 2003
From The Economist print edition

Until recently, health policy was a disaster. It might finally be getting somewhere



IF TONY BLAIR feels a whiff of nostalgia for war, it would not be surprising. At least everybody knew what the argument was about. There was a bad guy with a moustache, and he lost. The government's parliamentary victory over the opponents of foundation hospitals on May 7th, by contrast, seems to have about as much resonance for the electorate as the Little-endians' defeat of the Big-endians, Jonathan Swift's satire on the pointless posturing of politicians in “Gulliver's Travels”. Even the few sad creatures who have studied the government's proposals for loosening the ties between hospitals and the National Health Service admit that they may not add up to a great deal more than the question of whether a boiled egg should be cracked at its pointed or its round end.

Why then has this argument been so passionately fought? Because both sides perceive, rightly, that even if giving hospitals a modicum of independence will not, in itself, make much difference, foundation status is the thin end of a wedge that Mr Blair wants to drive between central government and the health-care system.

Second opinion

Governments make their biggest mistakes early on. So it was with Labour and the health service. Education was given to David Blunkett, a determined reformer. He stuck with the Tories' changes, and Labour has reaped the rewards. Health was given to Frank Dobson, an old leftie. He saw the NHS not just as the embodiment of the Labour movement's values, but also an excellent organisation whose troubles sprang from the Tories' refusal to give it enough resources. More money would mean better health care. End of story.

The government started pouring cash into health four years ago, and, as a proportion of GDP, Britain's health budget has risen to around the EU average. By 2007, it will match that of France, often held up as an example of a country that treats its health system properly. Yet the money is not delivering the promised improvements (see article).

Hence the rethink, and the reforms to which it has given birth. Mr Blair's policy wonks persuaded him that the NHS was not the solution, but the problem—that Britain's health system needed to be run less according to Soviet central planning and more like west European models, with both purchasers and providers of health care largely independent of the state. Hospitals were to be cut loose from central control, to be allowed to borrow private money, set wage rates, specialise, expand—to manage themselves, in other words, under governing bodies to be elected by local people.

However, under attack from the combined forces of health-service professionals and trade unions (producer lobbies always oppose change) and the left wing of the Labour Party (which regards the scheme as a betrayal of the people by the prime minister), the proposals have been watered down. Foundation hospitals will be crawled over by even more central regulators than oversee bog-standard hospitals. Their freedom to set wages will be limited. The number of private patients they can take will be capped, which will leave them financially under the government's thumb, and will limit their exposure to competitive pressures from insurance companies. And the idea that foundation status should be a reward for quality and thus a spur to better performance has been binned, because that might lead to some hospitals getting better than others. Horrors!

Yet, even in its watered-down form, the idea is still worth pursuing, for it may prove the basis for greater independence in the future. But the hostility the government has met over its attempts to reform the provision of health care bodes ill for reforming the other, more important, side of the equation—the purchase of health care.

Giving producers the freedom to manage themselves—the idea behind foundation hospitals—is central to making a system work efficiently. But unless purchasers can make their preferences felt, producers have no incentive to improve.

That's why the Tories gave doctors budgets with which to buy services from hospitals. Labour dismantled this system when it came in, for no better reason than that it stank of market economics, and Mr Dobson was running the health ministry. Health-service productivity, which had risen in the previous five years, plummeted.

As part of its rethink, the government is reintroducing an internal market, through Primary Care Trusts (PCTs), which now manage three-quarters of the country's health budget. So far this has made no difference to hospitals, since they do not lose money for failing to get the PCTs' custom. But, starting later this year, that will change. For 15 important treatments, including hip replacements and cataract operations, PCTs will pay hospitals by results. Over the next five years, that will be extended to other treatments.

The rumpus to come

This is fine in principle, but there are two problems. First, the government has got its reforms upside down. For competitive pressures to work, purchasers need to be just as powerful as providers. But PCTs are sad, neglected creatures that may not be a match for foundation hospitals. While foundation hospitals will be able to make their own decisions and will derive some legitimacy from their locally elected boards, the PCTs answer directly to the men in the ministry.

Second, the new system will sharpen hospitals' performance only if the PCTs' power bites. That will mean some hospitals' revenues increasing, and some falling. The rumpus over foundation hospitals will be as nothing to the row that will erupt when the internal market starts to put the squeeze on bad hospitals.

For Mr Blair, the battle over the health service is far more draining and politically costly than the war with Iraq. He has given too much ground already. But if he caves in altogether, he will face a more dangerous adversary than either Saddam Hussein or the left wing of the Labour Party: voters wanting to know why he has wasted their money.

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Letters

May 8th 2003
From The Economist print edition

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The spam busters

SIR – Spam is designed to get one to visit a website and buy something ("Stopping spam", April 26th). It is the operators of these websites who need to be held accountable for their advertising practices, not the people who send the junk mail. If website operators are fined or regulated out of business as a result of their advertising methods, spammers will no longer be able to sell their services quite so readily.

Pete Bothner-By
New York

SIR – Spam is an economic and a public-health threat in developing countries with poor connectivity and where internet service providers give only a dial-up service. It takes far longer for users to download each message and because both ISP and telephone usage is metered there is a direct financial cost for downloading spam.

In the developing world, e-mail has become an important tool for delivering medical information to health professionals and supporting e-commerce initiatives. Spam could drive up the cost of e-mail to the point where many will no longer be able to afford it.

Libby Levison
Harvard, Massachusetts

SIR – Spam is pollution of e-mail, just as oil spills pollute the sea. If the polluter pays, then pollution will reduce. Collect a one-cent tax on each e-mail and put spammers out of business without inhibiting legitimate direct marketing. It would be the most popular new tax in living memory.

Mark Elliott
Twickenham, Middlesex

SIR – Pressing the delete key umpteen times an hour to get rid of unwanted e-mail obviously exposes me to repetitive-strain injury. I feel a class-action lawsuit coming on. Please forward me Eliot Spitzer's e-mail address and I will get the ball rolling.

Stanley Pignal
London

SIR – Is spam not one of the best examples of the free market—your favourite ideal—at work?

Michael Price
Vancouver

Royal misconnections

SIR – While Niall Creed is correct to point out Ariel's rightful status as a Disney princess, he mistakenly marries her off to Prince Stefan (Letters, May 3rd). He surely means Prince Eric.

Ariel Haynes

Bellevue, Washington

Malaysia replies

SIR – Your survey of Malaysia (April 5th) is full of errors. For example, Christopher Lockwood hopes that the quota system for entry into Malaysian public universities will be abolished; yet it was discarded in 2001. He says that even foreign banks in Malaysia are obliged to provide Islamic banking services. This will come as a big surprise to Malaysia's Central Bank and the many foreign (and, for that matter, domestic) banks in Malaysia.

He says that under Malaysia's version of America's Patriot Act, "ministers have almost unfettered discretion to hold suspects for an initial 60 days." This will be news to Malaysia's ministers, not a single one of whom has fettered or unfettered discretion "to hold suspects". This power lies with the police.

Mr Lockwood says that Malaysia's very competitive democratic system is not between political parties but "among shifting coalitions, whose membership is never fixed for long". It so happens that the Barisan Nasional, the ruling coalition that has been at the centre of Malaysian politics since 1972 has been incredibly stable, with a membership practically unchanged—and at the core certainly unchanged—for 31 years.

Even more serious are the snide remarks. With all due respect, who are the "many" Malaysians who see Mahathir Mohammed, the Malaysian prime minister, more "as a jailer than a guardian of his people"? In what way has Dr Mahathir been a dictator? Mr Lockwood reserves the unkindest personal cut for his final sentence: "The greatest service Dr Mahathir could render Malaysia after all these years would be to retire, full stop." Yet Dr Mahathir has clearly and repeatedly made known that he intends to step down completely from every government post in October. What is the point of telling a man to step down when he himself decided, without the slightest pressure or provocation, at the very pinnacle of his popularity, that that was exactly what he would do?

Malaysia is said by you to be a "qualified success". Pray, do tell us what country in the world over the last 1,000 years is an unqualified, complete and utter success? And pray do tell us how many developing countries have done better than Malaysia under a man whom Mr Lockwood himself acknowledges is the longest serving "democratically elected leader in power anywhere in the world"?

Mustapa Mohamed
National Economic Action Council
Putrajaya, Malaysia

Editor's note: We apologise for our error over university quotas: a new merit-based system has been implemented this year. However, foreign banks do indeed say they feel obliged to offer Islamic banking. The composition of the Barisan Nasional does keep changing (we did not say the "core" did). Under the Internal Security Act the police act on the orders of the home minister, with no substantive judicial review. Readers can judge our survey for themselves here.

SIR – I am listed among those interviewed for the survey on Malaysia and therefore by implication a contributor. I do not appreciate this type of blanket attribution, which brackets me with a number of persons whose views I do not share.

Where your survey relies on objective analysis it is unexceptionable and I thank you for your tribute to the "remarkable achievements" of our prime minister, even if to my mind it is inadequate. This man raised up our society and as Malaysians we honour him. It is the subtext of snide commentary to which I object. This is much more subjective and appears to single out Dr Mahathir personally for unwarranted criticism.

Francis Yeoh
YTL Corporation
Kuala Lumpur

SIR – The *Bangkok Post* of April 28th reports Malaysia's foreign minister, Syed Hamid Albar, calling for a "ban on publications that belittle the country". This was apparently in response to *The Economist*'s view of Dr Mahathir's "dictatorial leanings". Worryingly, they appear to be spreading.

Jolyon Pawlyn
Bangkok, Thailand

The lost children

SIR – Your article on the appalling practice of female feticide in India highlights an abortion rate of up to one in six girls in one district ("Missing sisters", April 19th). In 2001, the abortion rate in England and Wales was nearly one in four of all pregnancies. Are you less critical of this rate of abortion because it appears not to discriminate between female fetuses and their brothers?

Peter Tully
Montreal ,Canada

Give a dog a bad name...

SIR – Regardless of whether poodles are French, or German as Nicholas Richardson (Letters, April 26th) claims, I still think they should be called "Freedom Poodles".

Andrew Berg
Newburgh, New York

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Economist.com SPECIAL
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Europe's minorities

Forget asylum-seekers: it's the people inside who count

May 8th 2003
From The Economist print edition

Panos

The real issue for European societies is not how to keep new foreigners out but how to integrate the minorities they already have

TWO young men set off with suicide bombs to Tel Aviv. One carries out his deadly mission, the other fails. Embittered Palestinians? No. Both are Muslim Britons, one indeed born in Britain.

Why did they do it? The easy answer is extremism—learned in Britain. Few British Muslims are extreme in their faith; hardly any, however they feel about Palestine, are in favour of terrorism. Yet those two men are not just nasty mavericks. They symbolise a wide-ranging question with no easy answers: can Europe integrate its mainly new, and growing, minorities?

Ask the habitually tolerant Dutch. The most potent phrase in Dutch politics today is *normen en waarden*, norms and values. Traditional Dutch ones, of course; yet few Dutch people two years ago had ever heard the phrase, or thought about the values. Then came September 11th, and then a politician called Pim Fortuyn. Suddenly the Dutch elite noticed what ordinary citizens had long believed, but not dared to say: that many of their immigrant neighbours did not (or so the average Dutchman felt) share these Dutch values.

It was a moment of truth, not only for the Netherlands but for the whole of northern Europe. At last, not just were the long-term effects of immigration openly on the agenda but it was permissible to be open about them; in particular, to admit that they would not go away again if only the plebs would put aside those racial and other prejudices which the better-educated, suburban-dwelling liberal elite wouldn't dream of sharing. Fortuyn was shot dead a year ago; his party was soon in chaos. But the veil that decency and goodwill had cast over discussion of such questions has been decisively torn away.

The main noise since then has been about asylum-seekers and how to keep them out. But the real issue is the immigrants, and their descendants, who are already inside. Integrate these, and European societies could cope well enough with the relatively few asylum-seekers.

That demands changes of attitude in the host societies and among the newcomers. In many European countries it has not been achieved: witness the shaky attempt in France, which has 4.2m Muslims, to set up a council in which they can find a political voice. Yet most of rich Europe is scrambling towards

Social disunity could be a huge long-term threat

this ideal. Rightly so: social disunity could be a huge long-term threat to Europe, and, as the past two years have shown, harmony does not grow on trees.

to Europe

Count in their locally born descendants, and there may be 12m-15m poor-country “immigrants” inside the EU: Turks and Kurds, Arabs, Asians (mostly from India, Pakistan and Sri Lanka), all manner of sub-Saharan Africans, Caribbeans, Latin Americans. Some of these communities are long-established, like the West Indians who were first brought into Britain to meet labour shortages in the 1950s, or the Turks who helped to prolong Germany's *Wirtschaftswunder*, the economic miracle that began 40-odd years ago. Some are newer, like the Bangladeshis who have poured into Britain within the past 20 years. But all share two things. First, they are communities, mostly distinct in skin-colour, language and religion from the natives, and not just random collections of individuals. And, second, these communities are not integrated into the society around them.

Just how large they are, from where and settled where, no one knows; in part, because definitions vary. Nordic statistics, for example, tend to lump together new arrivals with the children, even grandchildren, of earlier ones. There are solid reasons for that: the children of, say, brown-skinned, Muslim, poor Pakistanis will certainly be dark, nearly always Muslim, mostly able to speak Urdu, and often, as adults, poor. Yet there are also solid reasons against: nearly all will be vastly more fluent than their parents in the language of their adopted land, and familiar with its ways. And their children, in turn, still more so.

Count in their locally born descendants, and there may be 12m-15m poor-country “immigrants” inside the EU

And that is the trap into which most European countries, unwittingly, have fallen. Because natural assimilation has worked in the past, they have sat back to let it do its natural work again.

That was not absurd. Most of Britain's 300,000 Jews are descended from east European immigrants of around 1880-1910. When these arrived, they too were concentrated in poor east London; they too spoke foreign tongues, had their own religion and habits, and were often disliked by the natives, some better-off and long-established Jews included. And officialdom lifted barely a finger to turn them into Britons. That was left to the—often vigorous—efforts of sympathetic, or worried, Jews already in place. Yet by now Britain's Jews (the Hasidim apart) are as assimilated, as British, as any descendants of the Angles or Normans. They did it; why not leave others alone today to do the same?

Because things have changed. Today's newcomers have come fast, and in far greater numbers. They are, literally, more visible to the eyes of native prejudice; and, the spirit of 2000 being far from that of 1900, they—and still more their children—are likelier to resent prejudice than to hunker down, hope not to be noticed and put up with it when they are. Nor have many shown the vigour that saw Britain's Jews spread where they chose and win the acceptance that education, money and a position in the world habitually buy; Britain's Gujaratis, originally from western India, are a parallel case, but a rare one. Maybe all should have assimilated, but the fact is they haven't.

Things have changed. Today's newcomers have come fast, and in far greater numbers

So it is that Oslo has its “little Karachi”; that to Berliners the Kreuzberg district means Turks; that a Parisian calls Montreuil, just to the east, “the second capital of Mali”; that you can count 20 pupils coming out of a Rotterdam primary school before you spot the first obviously Dutch one.

Two halves make a whole

Yet, until recently, few but specialists asked: what is to be done? Britain's Race Relations Board, set up in 1966, has grappled with the question only to reach, in most cases, the usual answer: teach the natives to be less prejudiced. That is a worthy reply, but only half of one. The other half should have been to ask what solid reasons might lie behind the prejudice, and what could be done about them, not least by the minorities at issue. To ask such things was almost like blaming Jews for anti-Semitism. But the answer to both questions is, quite a lot—some of it just the reverse of what good-willed people have done till now.

Go back to the Dutch. Their society was for centuries built on the “mosaic”, not “melting-pot”, notion of integration: we are Catholics and Protestants (and more), we have each our own churches, schools, even sports clubs. But we live in mutual respect, we're all Dutch. Then in late 2001 they got a shock,

symbolised by a magazine poll that asked Muslims their view of the September 11th attacks. A bad thing, said 61%. Fair enough? No: what kind of community is it where 39% do not automatically condemn the murder of 3,000 innocents? Not much of one, said the native Dutch—and “not like us”.

So? One response was gut hostility to at least the Arab incomers: the word *Marokkanen*, preceded by an obscenity, was soon in public use. Another was to demand still fiercer immigration controls than the already tough ones brought in earlier in 2001. But the thoughtful answer—it was Fortuyn's, rapidly taken up by other parties, right or left—was to think how to make the country's Muslims more like “us”.

In Rotterdam, where the Fortuynists became the largest party on the city council, the resultant coalition made a priority of *inburgering*, the forming of citizens. Get more immigrant children into kindergarten, make sure they master the language, push them to stay longer at school and get better job skills. And act correspondingly for adults, newly arrived or long resident: encourage or shove them into citizenship courses, show them how ordinary Dutch society works and how it thinks.

Such notions can spring from and lead into racism. But it is hardly an act of hostility to make people improve their social or work skills; it happens to all schoolchildren. And to most of the native Dutch, this was simply a reasonable “when in Rome do as the Romans do”, and a recognition that this acculturation was not happening fast enough, but needed to be pushed.

This approach is now spreading fast. Indeed the Danes, a people very conscious of their immigrants, would say they pioneered it. They elected a Liberal (ie, free-market) government in late 2001, and a new ministry for “immigrants and integration” began not just fiercely shutting the doors but also pushing the integration that the previous government had merely talked about. The emphasis is on jobs: “Work is the key to integration.”

Both sticks and carrots are used. Welfare benefits for all the newly arrived have been cut—for their first seven years!—to well below the rates for most Danes. But they can now work part-time while drawing these. To help the process, the newcomer must sign up to compulsory courses in civics and language and, if need be, compulsory work placements. Fail to comply, and your stingy benefits will become even stingier. But extra money is going into integration, for example, to job counselling for immigrants and to educating foreign women brought in for marriage.

That is the theory, and these are early days. Already problems are plain. The government says what is to be done, but the local authorities have to do it, and don't find that easy. Tighter controls on bringing in a bride are unlikely to drive a young male immigrant into instant marriage with a blue-eyed blonde. Nor will a need for nine years of legal residence, plus other requirements, before he can be naturalised as a Dane help to make him feel like one.

That is the trouble: the clash between the widespread European feeling of “Let's have fewer of these people”, and being more welcoming to those already inside. Norway, which is following Denmark down the compulsory “induction” route, has less anti-immigrant feeling. But a new rule won by its most anti-immigrant (and, at this moment, most popular) party bars accepted asylum-seekers from bringing in family members unless they can support them. That will push some people to work, but it will hardly make them feel they belong—and it is not meant to.

Headscarves and cricket

Germany for years exemplified a rather different paradox. It welcomed its “guest-workers” as workers, but no way, least of all by easy naturalisation, did it try to integrate them. The newcomers naturally tended, and cheerfully were left, to stick in their national groups, socialising, shopping and praying with each other, reading their own newspapers—Turkey's *Hurriyet* has a flourishing German-printed edition — and more recently watching their own satellite-television programmes.

An immigration law was passed last year, aimed, among other things, at integration, with publicly financed courses in German language, history and other citizen-like knowledge. Compulsory courses? That was left unclear, as the law itself still is: for procedural reasons, not content, the Constitutional Court last December struck it down. It may yet be revived.

Britain, in contrast, though endlessly alarmed these days about asylum-seekers, has done startlingly little to integrate the millions of immigrants and their offspring, largely from its ex-empire, that it already has. And until recently, and still very largely, the British line has been to accept the resultant mosaic, cross

one's fingers and hope: no compulsion here.

Though the state has been slow to finance Muslim schools in Britain, multiculturalism is still the rage

Though the state has been slow to finance Muslim schools in Britain (the Netherlands, in contrast, has more than 40 already), multiculturalism is still the rage. Many urban local councils put out documents in several languages. And visiting cricket teams from Pakistan or India win loud support from their ethnic cousins, though most of these are British-born and thereby British citizens; a phenomenon that irritated one of Margaret Thatcher's senior ministers, but worries few people in Britain and prompts fewer still to suggest any measures that might alter it. Only recently has an authoritarian home minister begun to think of forcing newcomers into British ways, and even he is thinking strictly of newcomers. The case of the Tel Aviv suicide bombers may yet promote fresh thinking; so far it has promoted only fresh security measures.

The French notion of integration, in contrast, is strictly that of the melting-pot, with the heat supplied by “republican values”, secularism not least. That noble ideal can produce tortured arguments over the right of Muslim schoolgirls to wear headscarves. But, worse, it led for years to official unreadiness to admit that there was a problem with, specifically, the large Arab and Muslim population, and one requiring active treatment.

Since the September 11th attacks, and amid rising alarm about Muslim terrorists, especially from Algeria, there has been much talk of the need for newcomers to accept French values, but little certainty of how to achieve it. The authorities have long been eager to see Islam “naturalised”, with imams trained in France rather than sent and paid for from abroad. France, a secular state by constitution, cannot finance religion. It has, however, been fairly generous in regularising the status of illegal immigrants: of 140,000 who applied when the left came to power in 1997, 80,000 were accepted. This gives some ammunition to the racist right, but it is surely a step towards integration.

This year has brought one more overt effort that way: the setting-up of a single national Islamic council to act as an interlocutor with the authorities. But will this in fact bring more integration—or less? The new body, which met for the first time on May 3rd, was elected in April by delegates from nearly 1,000 mosques. But are these the authentic voice of the Muslim community? The Archbishop of Paris, not alone, doubts it, arguing that most Muslims do not go to the mosque, and that “you can't reduce the issue of North African immigration”—much the largest—“to one of Islam”. What's certain is that the election gave a large voice to Muslim traditionalists and fundamentalists, and these were soon challenging the government over headscarves (in identity-card photos, this time). If such clashes occur often, the new council could be a factor against integration; and the interior minister's threat to deport imams who challenge republican values, which is not yet a crime in France, is no great way to teach those values.

Spain and Italy, parts of which centuries ago were actually ruled by Muslims from North Africa, are by northern standards surprisingly relaxed about their immigrant descendants. Spaniards are proud of the Christian *Reconquista*, but also of their Muslim heritage; they hear more about the dozens of Moroccans drowned trying to cross the straits of Gibraltar than about the thousands labouring in Andalusia's horticulture and elsewhere. Italians once had a historic phrase “*Mamma, li Turchi!*”—the Turks (ie, Muslims) are coming! But they are likelier these days to know a not-so-historic north-Italian joke, and it is not immigrants who are its target:

> Q: Why did Sicily win the Nobel peace prize?
> A: Because it was the only Arab country that didn't make war on Israel.

Italian governments have often acted to legalise illegal workers: measures in 1990, 1995 and 1998 each gave papers to more than 200,000 people. Though one party in the Berlusconi coalition government is openly anti-immigrant, a fresh offer from that government last summer brought almost 700,000 applications. How many will succeed is unclear, given the slow start to the process and the doubts among Mr Berlusconi's governing partners, who see this as a means not of promoting integration but of sorting out who wants to work and who does not, and excluding the latter. The permits in any case will be valid only for a year, though renewable.

More recently, the home minister offered “dialogue” to Italy's moderate Muslims, aiming to isolate the extremists: a move mostly welcomed by Muslims, although the Archbishop of Turin stirred the pot by saying that the church should offer them the Gospel as well. But to Italians the problem with immigration is not so much one of alien values as of the arrival, with the Balkan immigrants, Muslim or not, of Mafia

values. And acculturation is still, as ever, left to work largely by itself.

Citizenship and the vote

There is one obvious way of helping it along: citizenship, or at least the vote. Treat people as voteless foreigners, and why would they feel anything else? Let them vote, and maybe they will feel at home. In fact, this remedy may not be much of one. As Commonwealth citizens, most members of Britain's minorities, even those not formally British, can vote already. Anyone born in France (or most European countries) is a citizen automatically. In contrast, Germany until 1998 based citizenship on descent, not birthplace, and required 15 years of residence before an outsider could be naturalised; most of its ethnic Turks are still Turkish citizens. Yet as between France's Arabs, many of whom are French citizens, and Germany's Turks, it is the Arabs who feel, and are seen as, more alien.

Still, political rights must have some integrative value. EU countries already let each other's citizens vote in local elections. Now the EU's economic and social committee is arguing for “civic citizenship”, which would give long-term residents from outside equal local-voting rights—and indeed more valuable ones, such as equal access to education and jobs.

Whatever the method, one thing is sure: Europe needs active integration policies. It cannot just sit around and wait for time to sort things out. That has been tried. It has not brought disaster—but it could.

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National Health Service

Anyone see where the money's gone?

May 8th 2003
From The Economist print edition

Despite all the spending, the NHS has not got better. That may change

Get article background

THREE years ago, the diagnosis and the prescription seemed straightforward. The National Health Service was sick because it was poor. So take out the taxpayer's cheque book and step up the cash flow. Make sure the money reached patients by setting ambitious targets to deliver better and faster treatments. Back those targets with more staff and reformed working practices. And wait for the healing power of money to bring about a full recovery.

A year ago, the NHS plan of July 2000 was backed with more cash and the period of treatment was extended. Gordon Brown wrote a post-dated cheque for hefty tax increases starting in April 2003 to help fund an even bigger boost to resources over the next five years. The chancellor's money-no-object budget for health wowed not just the Labour Party but also the general public.

But as the tax increases have materialised, the euphoria has vanished. Money is abundant but it is delivering much less than expected. Now that the war is over, the NHS is once again the public's main concern. But polls show that people are unconvinced that Labour can deliver a better NHS. According to a recent YouGov poll, 69% believe the government is not delivering an improved health service.

One commitment is undoubtedly being met. Already this year, total health expenditure in Britain will reach 8% of GDP, meeting Tony Blair's pledge in January 2000 to match the average in the European Union.

But the pay-off from the spending splurge has been disappointing. According to Dr Ian Bogle, chairman of the British Medical Association (BMA), 80% of doctors have not seen any improvements from increased NHS spending. More nurses and doctors have been recruited, but much of the money is finding its way into higher pay, which has consumed a third to two-fifths of the extra funding, rather than more medical staff and better facilities. “The nightmare stalking the NHS is that we will end up with European levels of cost without European levels of access or quality,” says Nick Bosanquet, professor of health policy at Imperial College.

Hopes that extra money would turn NHS hospitals into hives of activity have been dashed. The reverse has occurred: the growth in hospital-based activity, measured by “finished consultant episodes”, has

slowed to a snail's pace. In the mid-1990s, this was growing by over 4% a year but it has recently slackened to less than 1% a year. The government says that more treatments are being switched from hospitals to primary care, but this seems unlikely to account for much of the shortfall since there is an acute shortage of GPs.

Doctors are being recruited, but not enough of them to meet the objectives the government set in the NHS plan. Between September 1999 and March 2002, the NHS took on an extra 29,000 nurses, 3,100 hospital consultants and 500 GPs. That means the government has already succeeded in meeting its target for 20,000 more nurses between 1999 and 2004. But it will struggle to meet its objective of recruiting an extra 7,500 consultants and 2,000 more GPs by next year.

The shortage of family doctors, who act as the “gatekeepers” to the more expensive hospital care, is particularly serious. The BMA says that GPs are facing one of the worst workforce crises in the past 50 years. This puts greater pressure on hospitals. Overworked GPs tend to refer more cases to consultants. And when people cannot see their family doctor quickly, they often go instead to a hospital emergency department. That costs over three times more.

Alan Milburn, the health secretary, boasts of the government's success in cutting waiting times. The NHS plan declared “a war on waiting” and promised that maximum waiting times would be reduced progressively from 18 to six months by 2005. They are now down to 12 months.

It has been fairly easy to get this number down, because few patients wait that long. At the beginning of last year, for example, 29,600 people out of a total waiting list of over a million were waiting more than 12 months. By contrast, there are currently more than 200,000 patients waiting over six months. So getting the maximum waiting time down to six months by 2005, which the government has also promised to do, will be difficult—not least because there is a feedback mechanism. “As waiting times go down, more patients are likely to be referred to hospital for treatment, creating extra workload and pushing up the waiting list again,” says Julian Le Grand, professor of social policy at the London School of Economics.

All this will be made more difficult by the effect of the European working-time directive on junior doctors' hours. Anticipating the new regulation, their working week will be limited to an average of 56 hours a week from August 2003. It will eventually fall to the general limit of 48 hours by 2009.

Top doctors' working practices are also a problem. Last October, hospital consultants in England and Wales threw out a new contract which ministers had hoped would get more work out of them. The government is now asking hospitals to strike local deals with consultants to increase their productivity. There's a lot to be said for that approach, but in the short term it is unlikely to yield the scale of productivity gains the government had hoped to unlock through the national agreement.

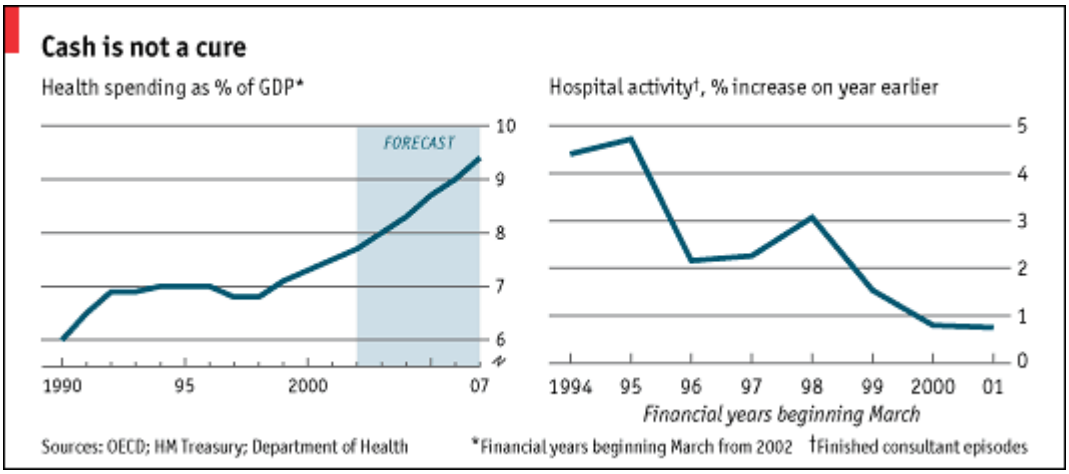
A new contract for family doctors has also been greeted with a storm of opposition, which forced a planned ballot to be postponed. And proposals for a radical overhaul of working practices among other hospital medical staff have not yet won the full support of workers. The “agenda for change” deal seeks to trade higher pay for higher productivity, mainly through a removal of professional demarcation lines so that people are paid for the job they do rather than their job-title. Nurses have backed the deal. But the support of other health workers represented by UNISON, the main health-service union, looks more uncertain when they vote on the scheme.

The born-again internal market

With so little to show for so much extra funding and increasing doubts about whether a centralised target-led approach can ever work, the government has changed course. The original NHS plan paid only lip service to patient choice and competition—not surprisingly, since Labour had just devoted a lot of time to abolishing the Conservative reforms that had empowered GPs with real money and allowed them to purchase hospital care for their patients.

Now the health department is playing midwife to the rebirth of a market within the NHS. This financial year, around 300 local primary-care trusts (PCTs)—reconfigured local health authorities with GP representatives—will control three-quarters of total health spending. As well as organising primary health care with GPs, they will commission hospital-based services under contracts that reward providers that do more and penalise those that do less. The idea is that, eventually, money will follow the patient. “It's very much an extension of the ideas I had in mind with the internal market,” says Alain Enthoven, a

health economist at Stanford University who was the intellectual architect of the Conservative reforms.



Already pilot schemes have been operating in London for patients waiting more than six months for cataract operations and across England for heart operations. From July, the cataract pilot scheme will be extended to other parts of the country and patients will be offered a choice of hospital when the GP first refers them for an operation. More important, starting this year, for 15 priority treatments with long waiting lists, such as hip and knee replacements and varicose-vein operations, hospitals will be paid by results. The objective is that within five years, virtually all treatments will be purchased using a national set of prices, adjusted for regional cost differences. This will give PCTs much greater leverage over hospitals.

Making a success of the internal market will be difficult. Although the government says that the use of fixed prices is common in other countries, working out the right ones when medical technology evolves so quickly will be difficult. Fixing prices weakens the incentive for hospitals to compete on cost and makes it harder for them to compete on quality where this involves more expensive treatments. And the threat of failure, which keeps businesses on their toes in the real world, will not hang over hospitals. PCTs will have to keep their local hospital going in order to deal with accidents and emergencies.

Despite these drawbacks, the current plan, with its focus on purchasing and financial incentives, is much better than the original Soviet-style NHS plan of July 2000. A form of internal market has been operating in Britain's schools for some years. Budgets are tied to the number of pupils, so schools must compete for them. That has forced schools to think harder about their results.

The politicians will have to put some effort into making this model work in the more complicated health sector. The PCTs have to be strengthened so that they can square up to the powerful hospitals that have held sway since the NHS was created in 1948. In particular, they have to get good at shopping around for health care, not just in the NHS but also from private contractors. So far, the signs are not encouraging. “Many PCTs have had difficulty in attracting good people and as a result are preferring to concentrate on reorganising primary care rather than the more difficult commissioning function,” says Professor Le Grand.

In principle, foundation hospitals could be building-blocks in a more effective internal market within the NHS. Answerable to locally elected boards, they will enjoy more freedom to run their affairs, including greater power to set their own wage rates, to borrow from the private markets and to retain surpluses. The hope is that they will escape the Whitehall paperchase, take charge of their own destiny and become more enterprising. If this really happened, it would be a constructive reform. One reason why other health systems work better is that there are more independent providers of hospital care.

But if the revived internal market is to work, there have to be winners and losers. Some hospitals could lose 30% of their revenues, according to a study by John Appleby, chief economist of the King's Fund, a health-policy think-tank. So it is worrying that Mr Milburn appeased dissident Labour MPs by saying that all NHS acute hospital trusts should achieve foundation status within five years—so blunting the incentive for the weaker trusts to improve their performance. If the internal market becomes a caucus race in which everyone wins prizes, it won't work.

Another worry is that the reform will reinforce the power of hospitals within the NHS, by allowing them to claim a greater local legitimacy. “It would be better to have elected boards on the PCTs rather than on

the foundation hospitals," argues Professor Le Grand. If hospitals get to dictate what happens, PCTs may be dissuaded from encouraging GP's surgeries to do more. That would be bad, because it is so much cheaper to deliver medical care outside hospitals.

Instead of devoting so much energy to reshuffling the pack within the NHS, the government should have done more to bring new entrants into the health-care market. Foreign companies should have been given more encouragement to expand into Britain. There have been long delays in organising bids from private and overseas providers. With shortlists only now being drawn up, there will be no substantial boost to capacity over the next couple of years.

The story is not all gloom. Much of the money has been wasted, but at least the government acknowledges it. The reforms it is now introducing are watered-down and half-cock, but better than no reforms at all. Mr Blair may pay a heavy price for flooding the NHS with money before working out that it needed reforming. On the other hand, British voters look about as likely to elect Saddam Hussein as Iain Duncan Smith in the next general election. So Mr Blair has still got some time to get things right.

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The economy

Another Bush, another jobless recovery

May 8th 2003 | WASHINGTON, DC
From The Economist print edition

AP

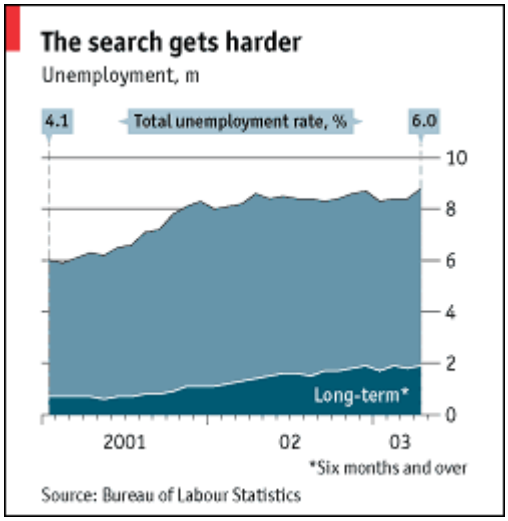
The jobs market looks bleak and the president's tax cut is unlikely to help

Get article background

OF ALL the signs that America's economy is sputtering, none is more striking than the jobs market. Overall unemployment, at 6%, is still relatively low, but this headline figure masks a much tougher reality. More than 500,000 jobs have disappeared in the past three months, pushing the total lost under George Bush above 2m. Long-term unemployment, at 1.9m, is at its highest for ten years. And these numbers do not include the large number of “discouraged workers” (people who would like to work but have given up looking) and the even larger number of “underemployed” (those who are working, but not as much as they would like to).

The weak jobs market is itself harming the chances of recovery. Consumers worried about losing their jobs are more likely to save their cash than spend it. And politically, the risks are even starker. George Bush senior famously lost the 1992 election during a jobless recovery.

Why is the job market so weak even though the economy is (just) growing? A big reason is the continued impressive growth in productivity. Ever more efficient firms need ever fewer workers, and with the economy barely growing that means job losses, particularly in some industries. According to economists at Morgan Stanley, hotels, airlines, restaurants and amusement parks, which together account for only around one in ten private-sector jobs, contributed nearly half the job losses in the past three months.



Another deterrent to hiring people is the price of benefits. The growth in the cost of things like health-care insurance accelerated to 6.1% in the first three months of 2003, the highest rate since 1992, when costs were actually decelerating.

The result is not just that more people are losing jobs, they are staying out of work for longer. People who become unemployed

now stay out of work on average for almost 20 weeks, the longest since early 1984. The proportion of workers who exhaust their unemployment benefits before they find work is the highest since records began in the early 1970s.

What will turn this gloomy picture around? Optimists reckon that many ingredients for an economic rebound are already in place. With the Iraq war over, the geopolitical uncertainty that hobbled business investment has fallen. Oil prices have fallen back, consumer confidence has shot up, share prices are well off their mid-March lows and spreads on corporate bonds have narrowed.

In testimony to Congress on April 30th, the best-known optimist, Alan Greenspan, argued that the economy was “positioned to expand at a noticeably better pace than it has during the past year”. At its meeting on May 6th, the Federal Reserve's policymaking committee decided to keep short-term interest rates on hold.

But the central bank indicated that further rate cuts were possible, citing concerns about further falls in inflation. The committee split its assessment of risks to economic growth: these, it said, were evenly balanced between the upside and downside. But the probability of “an unwelcome substantial fall in inflation, though minor, exceeds that of a pick-up in inflation from its already low level”. The Fed, it seems, would be willing to cut rates to ward off deflation even if the economy rebounded. And if there were no rebound, it would be even more likely to do so.

For the moment, though, monetary policy is causing less controversy than the other macroeconomic lever, fiscal policy. Ever since the end of the Iraq war, political Washington has talked about little else.

Mr Bush is increasingly selling his tax-cut proposals as a job-creation package. In Arkansas this week he said that the 6% unemployment rate should serve as “a clear signal” to Congress: “we need robust tax relief.” The White House claims that if Congress passes tax cuts worth at least $550 billion over ten years, it would create 1m new jobs by the end of next year. A long-awaited study by the administration's number-crunchers is rumoured to show that one-third of these new jobs would come from eliminating dividend taxation, while many of the rest would come from accelerating cuts in marginal income-tax rates.

A reform but not a stimulus

Sadly, Mr Bush's claims are not convincing. The notion that a tax plan's ten-year price-tag provides any measure of its efficacy as a short-term stimulus is absurd. The central component of Mr Bush's tax plan—the elimination of dividend taxation—would improve the tax code and, probably, long-term growth, but it would do little to boost the economy now. Mr Bush's people say that ending dividend taxation would raise share prices, which in turn would boost spending. Most economists reply that the boost to share prices would be fairly undramatic (a 5-15% jump is the consensus guess); and any effect on spending would be small and gradual.

For all his hustling, Mr Bush's original plan is being heavily modified in Congress. Both the House and Senate are in the process of passing different tax-cut bills.

On May 6th, the House Ways and Means Committee passed a $550 billion tax package, whose central provision was to cut taxes on both dividends and capital gains to 15%. As *The Economist* went to press, Charles Grassley, the chairman of the Senate Finance Committee, seemed to have won support from his fellow Republicans for a bill including $430 billion of tax-cuts over the next decade. His bill would exempt the first $500 of dividend income from taxation (which would mean most investors paid nothing). There would then be a sliding scale of cuts for richer investors who pay most of the tax. Altogether, it would cut dividend taxes by only a fifth—which would annoy Mr Bush. Conservatives are also unlikely to be happy with a $20 billion bail-out for the states.

That last provision could win Democrat support. Money for the states is part of Senator Tom Daschle's $152 billion package—alongside tax credits for families and businesses and an extension and expansion of temporary federal unemployment insurance (which the White House is prepared to let expire at the end of May).

In the end, the Republican Congress looks likely to force through a stimulus package that is largely based around tax cuts. Some of these measures may be sensible long-term reforms, and returning money to taxpayers is seldom unpopular. But the stimulus will not create many jobs now, whatever Mr Bush says.

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School vouchers

The mayor throws a lifeline

May 8th 2003 | WASHINGTON, DC
From The Economist print edition

And the Democrats are forced to choose between teachers and blacks

Get article background

THE District of Columbia may contain the capital of the most powerful country in the history of the world. But the local public schools smack more of Ruritania than Imperial Rome.

Though they boast the third-highest level of per-pupil spending in the country, 70% of pupils in the District score at or below the basic level on standardised reading tests (ie, they can barely read) and 71% score at or below basic in maths. In one infamous high school, Anacostia, 92% of children score below basic in maths. Illiteracy is so rife that, when the mayor was organising a “write-in” campaign in 2002, his supporters were forced to hand out pre-printed stamps. Anybody rich enough either moves to the suburbs or pays through the nose for private schools.

Now at last there is a flicker of hope for the 67,500 children trapped in DC's public schools. On May 1st, Mayor Anthony Williams publicly embraced school vouchers during an appearance with the education secretary, Rod Paige. He now thinks that vouchers can provide opportunities for children caught in failing schools while also galvanising the system as a whole.

Mr Williams, a black Democrat, is the first DC mayor to speak out in favour of vouchers. But he is far from isolated. Peggy Cooper Cafritz, the president of the Board of Education, dropped her long-standing opposition to vouchers in March. Kevin Chavous, the chairman of the City Council's Education Committee, is reconsidering his position. Several parents' groups want vouchers. The *Washington Post* has come out in favour of the idea.

Why has the Democratic mayor of an overwhelmingly Democratic city thrown his support behind school choice? Mr Williams faces cuts in the budget for his schools next year unless he can conjure up more money. But Republicans both in the White House and on Capitol Hill have made it clear that money will be contingent on structural reforms. So Mr Williams is offering a bargain: he will support vouchers in return for substantial increases in federal funds for both public and charter schools. He is particularly keen on the federal government taking responsibility for $100m of the District's ballooning annual budget for special education, which is provided for 18% of the District's children.

What chance is there of Mr Williams's fine words bearing fruit? Casey Lartigue of the Cato Institute points out that, in most cities, the teachers' unions are an almost insurmountable barrier to radical change. But the local union branch is currently in disarray after accusations that union officials embezzled as much as $5m.

The White House is also determined to shake up the city's schools. How could George Bush better burnish his standing with blacks than by improving the schools in a city that is mostly black? And what better advertising board for the virtues of school choice than the nation's capital?

Still, there are several bumps on the road. One is practical: it is unlikely that vouchers will cover the huge annual tuition bills of Washington's private schools. Some of the slack may be taken up by the District's Catholic schools, which have 1,200 spare spaces. There are also whispers that John Walton, a businessman who has made a habit of funding school choice, may help finance scholarships.

Power to the parents

But practical problems will be nothing compared with the political variety. Eleanor Holmes Norton, the District's delegate to Congress, is furious that Mr Williams may have been negotiating with the federal government behind her back. She has accused him of making secret deals and “selling out” home rule. On May 6th she spoke at an anti-voucher rally.

The “deal” in question depends on a law being passed, and no bill in the works fits Mr Williams's wish-list. The one congressional bill that is currently pending, proposed by Jeff Flake, only makes money available for vouchers, and has little chance of getting through Congress. Mr Bush's education budget for 2004 includes funding for a pilot voucher programme in the District but does not address Mr Williams's other financial demands.

For all that, the prize is well worth fighting for. Introducing vouchers into DC will not only bring hope to thousands of children who are trapped in a rotten system. It will force the Democratic Party to choose between its most loyal constituency—blacks—and some of its biggest paymasters, the teachers' unions. So far, the party has invariably sided with the unions. But the introduction of vouchers in the nation's capital may force it to pay a bit more attention to the majority of blacks who support school choice.

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An ill wind

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From The Economist print edition

Tornadoes define the character of the American mid-west as the mountains or the sea shape the culture of other people. Boards driven through tree trunks by tornado winds are preserved as icons in the state museums. In many towns, empty lots show where a home or business once stood; close by will be a shop defiantly proud of its multiple rebuildings after multiple destructions. These storms are so random that sometimes, in the rubble of a brick house, desperate searchers have found a fragile vase standing undisturbed on a table. Even by the standards of Tornado Alley, last Sunday's swarm was horrific. As many as 70 twisters formed, blowing at up to 260 miles an hour. They swept across Kansas, Missouri and Tennessee, killing more than 40 people and causing billions of dollars of damage. Pierce City, in south-west Missouri, looked as if it had been bombed. In the nearby town of Monett, police found the body of a baby. In Jackson, Tennessee, a historic district crumbled in seconds along with most of the rest of the town. Advances in forecasting, particularly Doppler radar—which can sometimes detect the rotation signature of the funnel cloud before it reaches the ground—have helped reduce casualties by increasing the warning time. But predicting and understanding tornadoes remains as much an art as a science. To live in the mid-west is to accept these venegeful twisters as a part of life—and death.

Reuters

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Campaign finance and the law

Money trouble

May 8th 2003 | WASHINGTON, DC
From The Economist print edition

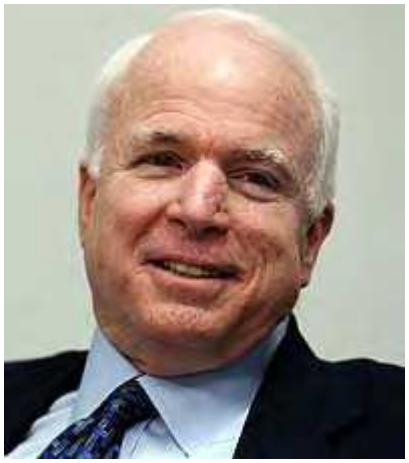
Campaign finance will be in legal confusion until next year

Get article background

AMERICA'S system of money-politics is the despair of everyone it touches. Hundreds of millions of dollars pour into political campaigns each election. Reformers say companies and unions buy votes and influence. Free-speech purists say rules that seek to limit that influence infringe on Americans' rights to political free speech. Even campaign professionals dislike a system so complicated that they do not know what the rules are.

Is there any chance America might come up with a more rational arrangement? The politicians and their moneymen have been scrolling through a confused ruling by a Washington court last week. The broad answer: the muddle will get worse before it gets better (which is awkward, seeing that the presidential campaign is just beginning to fire up), but it should be resolved by the Supreme Court, though probably not till next year.

AP



McCain's still standing

The starting point is last year's McCain-Feingold bill, which George Bush signed reluctantly, almost secretively, without telling the bill's sponsors, who included John McCain, his chief opponent in the 2000 primaries. The law's main provision is a ban on “soft money”—unregulated donations to national political parties. The bill actually doubles the amount of “hard money” individuals can give to a specific campaign to $2,000. Its other main reform is to ban “phoney issue ads”—commercials that purport to be about matters of general public concern (the environment, say, or national security) but which in reality attack your opponent. The law bans such ads in the 60 days before a general election and 30 days before a primary.

Under the microscope

After the passage of the bill, its leading opponent, Senator Mitch McConnell, announced that the battle was not lost; it had merely shifted to the courts, where, he predicted, the law would be struck down as unconstitutional. The first attempt to rule on it was duly given to a panel of two district judges and one appeals court judge in Washington, DC. It is their ruling, released last week, that the political classes are now combing through.

No one can say the three judges weren't thorough. Their ruling runs to over 1,600 pages. They also acted out in real life the old joke about “ask two economists and get three opinions.” The three judges have produced four findings: a two-to-one ruling for the panel and separate opinions by each judge.

On first reading, the panel seemed to have struck down the ban on soft money. Bulletins about the death of campaign-finance reform crawled across television screens. Now, it seems that these rumours were exaggerated. True, a blanket ban was held to be unconstitutional, so parties can again raise “soft money”. But they can do so only for general campaigning that has nothing to do with individual candidates: voter registration, get-out-the-vote drives and the like. (Since other parts of McCain-Feingold would have weakened the influence of America's party machines, this exception may be no bad thing.)

Yet the panel said national parties could not spend soft dollars on advertisements that attack or support

candidates for national office. Parties have mostly used their soft money to do just that, so, in practice, this confirms one of the main pillars of McCain-Feingold. The judges also backed a bit of the law that bans candidates for federal office from raising soft money for anything—putting members of Congress, congressional campaign committees and presidential candidates out of the soft-money business.

The panel's ruling on phoney issue ads has a similar effect. It struck down the 60-day ban on the basis that it could prohibit real issue ads as well. But the judges endorsed a back-up definition also in the law: no advertising like this is allowed at any time if bought with soft money. So you can run phoney issue ads, but you must pay for them with “hard money”—a big blow, since they have usually been paid for with the softer sort.

From this perspective, Mr McCain has not done too badly. His bill survived its first court challenge, though not unscathed. On the other hand, lobbying groups are already planning to run ads “targeting” specific members of Congress, saying the ruling is unclear enough to allow this. And Mr McConnell, who never predicted the bill's demise at this stage, has already appealed the case to the Supreme Court, where he expects to get his way.

Waiting for the Supremes

The politicians want America's highest court to start looking at the issue as soon as possible. But the first hearing is unlikely to happen before September, and given the complexity, the court may not reach a decision till next year.

Legally speaking, the court inherits one muddle, one important finding of fact and one broad choice from the district judges. The muddle may help Mr McConnell's side. The panel allowed the political parties to use soft money for things like voter registration, but not to support candidates. This seems odd. Running candidates is just as much a party's business as registering voters. Why can they use soft money for some things, and not others?

The finding of fact should help Mr McCain's cause. The majority of the panel agreed with the claim that the recent flood of soft money has been a problem. First, it circumvents previous congressional campaign laws. And, second, the source of the money is sometimes hidden. If the Supreme Court agrees, that should put the reformers in a strong position.

The broad choice has to do with regulation. Congress's approach to campaign-finance reform has been to add new rules to offset the unintended consequences of the old. One district judge approved of this, another tolerated it, but the third said regulations should be cut back to protect first-amendment rights of expression. The Supreme Court would seem to present similar odds: three justices usually opt for more regulation, three for less and three for (roughly) the status quo.

That does not necessarily mean that McCain-Feingold will squeak through in something close to its present shape. The Supreme Court can ignore the panel, if it wants, and effectively start the process afresh. For the moment, though, the main demand from politicians and their backers is for some sort of certainty. That, the justices should eventually give. But several months of confusion lie ahead.

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Local government

An honest man in New Jersey?

May 8th 2003 | PATERSON
From The Economist print edition

Not in politics, it seems

WHAT on earth is happening in New Jersey? Last week, Martin Barnes, the former mayor of Paterson, one of the state's largest cities, was sentenced to three years in prison for accepting more than $200,000 in bribes. He was also fined $1,000 for accepting cash, a swimming pool and the favours of a young lady, all provided by thoughtful city contractors.

Once behind bars, Mr Barnes won't lack for political gossip. Milton Milan, who used to be mayor of Camden, another big town, is currently serving a seven-year sentence for a litany of crimes. A former mayor of Irvington, Sara Bost, who has pleaded guilty to witness tampering, may soon join them. Last month, Kenneth Saunders, a former mayor of Asbury Park (of Bruce Springsteen fame), was charged with conspiracy and bribery. A former Newark mayor pleaded guilty to tax evasion last autumn.

And let's not forget the political boss of one New Jersey county who was recently indicted on 20 counts of extortion, fraud and conspiracy. Or the Hudson County official who was charged with bribery and has bizarrely disappeared into the witness-protection programme. And so on. Some three dozen indictments have been issued to New Jersey politicians in investigations in the past year.

Why has New Jersey suddenly become the Louisiana of the north? It is not a party thing: in New Jersey both the Republicans and Democrats seem equally criminal. The obvious people to blame are the state's much maligned “organised-crime community”: this is the land of Soprano as well as Springsteen. Many of the guilty mayors had ties to the mob.

Locals prefer to point to the fact that their state is unusually fragmented. Most of the power resides not with the governor in Trenton, but with its 21 counties, 566 municipalities and 600 school districts. There are tens of thousands of public officials who have access to large budgets of one sort or another. Many politicians double dip (hold more than one elected office).

However, the most plausible explanation for the sudden burst of convictions is that, until recently, nobody really minded. David Rebovich at the Rider Institute for New Jersey Politics argues that New Jersey voters have generally not been too concerned by political labels; what they have wanted is political pork—and that, they have accepted, meant cutting the odd corner. The impetus for the current arrests has come from an unusually hyperactive federal prosecutor, Christopher Christie, who has already (somewhat worryingly) been nicknamed “Big Boy” by George Bush.

Now there are demands for a bigger overhaul of New Jersey's numerous and dysfunctional municipalities. In theory, the Democratic governor, James McGreevey, is all for wholesale reform. But he has not yet committed to signing a law that would ban “pay for play” (ie, it would prevent campaign donors from winning government contracts).

There are some signs of change in public attitudes. Mr Christie is so popular that people are talking about him as “New Jersey's Giuliani”. One of the state's fastest-growing companies, Commerce Bank, has just stopped making campaign contributions in New Jersey, lest they be misinterpreted. Over three-quarters of New Jerseyans now say they think there is some political corruption in their state. Heaven knows what the other quarter are up to.

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About sponsorship

Lexington

Holy high-roller

May 8th 2003
From The Economist print edition

Laugh at Bill Bennett, the erstwhile virtuecrat; but don't forget his message

WHO needs satire when you have the social conservatives? These guardians of public morality mercilessly persecuted Bill Clinton for his zipper problem. But then it turned out that many of his persecutors were no better. Newt Gingrich deserted his sick wife for his girlfriend. Bob Livingston had to give up the speakership after extra-marital “indiscretions”. Even gentlemanly old Henry Hyde had a zipper problem of his own. Now Bill Bennett, the *capo di tutti capi* of the virtuecrats, has been caught, if not with his trousers down, then at least with his hand glued to the slot machines of Las Vegas and Atlantic City.

Mr Bennett, serving in Republican administrations as both education secretary and drug tsar, has scolded the nation's youth. Bob Dole seriously considered him as a running mate in 1996. His jeremiads against moral decline have made him a fixture of the chat shows and the lecture circuit (where he can command $50,000 a speech). His “Book of Virtues” and “The Death of Outrage” have sold in the millions.

Hardly the sort of man, then, whom you would expect to find standing next to you in some windowless room on the Strip. But reports in both the *Washington Monthly* and *Newsweek* show that, over the past ten years, the former drug tsar has lost some $8m gambling. He sometimes spent several hundred thousand dollars in an evening, mostly on slot machines. In one two-month period he wired more than $1.4m to cover his losses. Mr Bennett was accorded the lofty status of a “high-roller” in both Las Vegas and Atlantic City—and was even given free room and board at one of the Bellagio's swanky villas.

At first, Mr Bennett tried to defend himself on the grounds that he has never spoken out against gambling. “I've gambled all my life and it's never been a moral issue with me,” he told the *Washington Monthly*. “I view it as drinking. If you can't handle it, don't do it.” Gambling is neither illegal nor immoral, he argued; why, he even started his gambling career playing church bingo!

Bingo to that. You don't need to be a recently retired Democratic president to wonder if there isn't something just a little bit hypocritical about a man making millions out of preaching virtue and then feeding the proceeds into slot machines. Nobody has banged on more about the importance of “character”. To Mr Bennett, Mr Clinton's peccadillos were not just wrong in themselves; they revealed systemic flaws in his personality.

In his books, Mr Bennett pours contempt on libertarian nonsense about “harmless vices”. His writings are

full of dark warnings about the way that “instant gratification” and “unrestrained personal liberty” erode social norms. He lambasted America's bohemian elites for setting a bad example for the rest of society. Harvard graduates might be able to handle a bit of pot; but their example encouraged inner-city kids to turn into crack addicts.

But isn't all this true of gambling? The Mafia once used Las Vegas to recycle drug money. Many of the habitués of casinos are also given to the instant gratification of alcohol, nicotine and commercial sex. (In 2000 Nevada had one arrest for every 478 residents for prostitution or “commercial vice”; neighbouring California only had one such arrest for every 2,731 residents.) Many of Mr Bennett's allies on the religious right argue that addiction to gambling can produce a whole house of horrors. James Dobson, head of Focus on the Family, an organisation that distributes Mr Bennett's tapes, argues that there is “a direct link between problem and pathological gambling and divorce, child abuse, domestic violence, bankruptcy, crime and suicide”. Mr Bennett's own “Index of Leading Cultural Indicators” includes “problem gambling” as a negative indicator of cultural health.

The author of “The Death of Outrage” eventually produced a very Clintonian apology—saying that he had done nothing wrong and promising not to do it again. He has “complied with all laws on reporting wins and losses”, he says nobly. Mr Bennett admits that he has “done too much gambling”. Therefore, “my gambling days are over”.

Betcha hadn't thought of this one

Few things are funnier than a moraliser who is caught out. Yet after laughing at Mr Bennett, it is still worth re-examining his message, which is not so amusing. The issues he raises in his books—the breakdown of the family, the absence of trust, even sexual promiscuity—are important, and deserve better.

The scorn now being heaped on Mr Bennett is a little similar to that once heaved on to another apparent conservative buffoon, Dan Quayle, when he attacked Murphy Brown, a character in a popular sit-com who decided to have a baby out of wedlock. My, how America laughed at the dumb vice-president and his attempts to lecture the country about personal morality. But as the *Atlantic Monthly* pointed out a little later, Mr Quayle had a point: all sorts of social statistics show that single motherhood is not something to be recommended lightly.

Of course, one does not have to bring a moralising edge to discussions about character. People like the late Daniel Patrick Moynihan and even Mr Clinton (who talked a lot about personal responsibility) have managed to push morality into politics without appearing to condemn people. But Mr Bennett's more strident diatribes also made a point. Too many Americans are prepared to blame social ills on anything but character. It is surely better that buffoons, and even hypocrites, bring up these issues than that such questions are ignored.

As for Mr Bennett and his virtue empire, its fate is uncertain. So far, social conservatives have been strikingly supportive of their fallen brother. And the great American public loves nothing more than a sinner who repents. Mr Bennett will no doubt be able to write a bestseller on how to beat the betting demon—and this time the money he makes might spend a little more time fructifying in his own bank account.

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Crime in Brazil

What ails Rio de Janeiro?

May 8th 2003 | RIO DE JANEIRO
From The Economist print edition

AFP

The fight against drug-fuelled violent crime in Brazil's picture-postcard city has national implications

A BOMB explodes outside a posh hotel in Copacabana, Rio de Janeiro's best-known stretch of beach-front. A bus is set alight in nearby Botafogo, killing one person and injuring a dozen others. Gang warfare halts traffic on the city's main motorways. On the eve of a presidential election in October, threats and bomb attacks shut down shops and businesses in Copacabana and Ipanema. *Cariocas*, as the citizens of Rio are known, are used to living in one of the world's more violent cities, but the recent spate of terrorist-style attacks on Rio's richer quarters is something new.

It has served to highlight Brazil's endemic and multi-faceted problem of violent crime, which ranks with poverty and poor education as one of the three main development challenges facing Luiz Inácio Lula da Silva, Brazil's new left-wing president. His government sees the Rio outbreak as an expression of a social problem, which hurts poor Brazilians more than rich ones and is rooted in the disparities between them. His law-enforcement team is eager to prove that the left can deal effectively with an issue that has traditionally been a chief concern of the right.

But in Brazil, it is the states, not the federal government, who are mainly responsible for crime and policing. How well Lula's lawmen work with state political bosses will determine whether Brazil starts to restore a sense of security to its cities. They face long odds—and nowhere more than in Rio de Janeiro, whose state government has a woeful recent history.

Rio's governor, Rosinha Matheus, a mother of nine, owes her election last year to her husband, Anthony Garotinho, who stood down as governor to stand for president. On April 28th, amidst speculation that the federal government would intervene to take control of Rio's security, she handed that job to her husband, who remains the de facto ruler of the state. Nominally now an ally of Lula, Mr Garotinho wants to run against him in 2006. To do so, he must pacify Rio; for him, crime is a political headache more than a social ill.

Rio's crime is not typical of Brazil, and the recent attacks in the city's richer zones are not typical of Rio. Both have much to do with the city's thriving drugs trade and its dramatic topography, with slum-draped hills rising up from sea-level crescents where the rich live. The poor, crowded *favelas* supply drugs to adjoining prosperous quarters. To control the trade, one has to control the *favela*, and to do that requires

a teenage army. Today, most of Rio's 800 *favelas*, which have a total population of around 1m people, are controlled by one or other of the city's three main trafficking mobs. Their rule is enforced by just 5,000-6,000 “armed and active” youngsters, according to Luke Dowdney of Viva Rio, a local NGO.

The drug trade takes the toll of a war. In 1999, 482 people aged 15-17 were shot dead in Rio de Janeiro state—five times as many per head as in California. Most of the killing happens in fights between or within drug gangs or in police raids on *favelas*. According to Gláucio Soares, a professor at IUPERJ, a Rio research institute, 70% of the city's murders are related to drugs, a much higher proportion than in other Brazilian cities. Everywhere though, the vast majority of victims of violence are poor. The main threats to middle-class Brazilians are mugging, burglary and car theft, which rarely end in murder.

The attacks now unnerving middle-class *cariocas* are also drugs-related. They may be a reaction to new restrictions imposed on jailed gang leaders, such as Fernandinho Beira-Mar, who were accustomed to managing their operations from prison. Criminals “feel they can use terror as a political tool” to extract concessions from the state, says Luiz Eduardo Soares, the federal secretary of public security.

So far Mr Garotinho has offered gestures, ad hoc measures—and some bold promises. He ordered that prisoners be put to work making uniforms for the police as a “humiliation”. He says he will unify the state's police forces, which would be important if it happens. But he may be tempted to strike a deal with the drug traffickers, offering tolerance in the prisons in exchange for peace on the streets.

If Mr Garotinho goes for quick fixes, he will clash with the federal government, which has more radical notions of reform. Mr Soares, who is an anthropologist as well as Brazil's top law-enforcement official, is an unsparing critic of the country's police forces. Many generate “paperwork but not information” and do not know how to measure their own performance. The various agencies are hampered by “fragmentation” and through brutality and corruption alienate the citizens they are supposed to protect.

There is little Mr Soares can do about this directly. Each state has its own civil (detective) force, and its military police, a *gendarmerie*. He has a budget of 404m *reais* ($135m) to dole out to states that present plans for police reform. Not much, but some states are so broke that any cash can be a powerful incentive for change. Two, Espírito Santo and Rio Grande do Sul, have already agreed to reforms; Mr Soares hopes that Rio de Janeiro will soon follow.

The government's approach gives priority to prevention, especially of violent crime, and to co-operation with the states. Critics see in this a lack of toughness. Walter Maierovitch, a former drug tsar, scolds the government for making “no attempt to alter the constitution to diminish the autonomy of the states.” Lula knows, his critics allege, that Brazilian presidents are not normally judged by voters for their record in tackling crime.

That cannot be said of state governors. But which way will politics push Mr and Mrs Garotinho? Mr Soares says that he and Mr Garotinho “share the same vision” of reform. The former governor is probably the only person in the state with the authority to bring it about. What is unclear is whether he has the desire or the courage. While governor, Mr Garotinho hired Mr Soares, who embarked on a crusade against police corruption. The governor fired him 16 months later.

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Reforms in Brazil

Starting the marathon

May 8th 2003 | SÃO PAULO
From The Economist print edition

Lula places his fate in Congress's hands

AFP

Lula gets the governors in line

FOUR MONTHS into his presidency, Luiz Inácio Lula da Silva is still on excellent terms with Brazil and the financial markets. He remains popular (a recent poll shows approval of his government rising). The *real* has soared against the dollar and, on April 29th, Brazil issued a bond on the international markets after a year-long absence (see article).

A day later, the president took his boldest step so far. Accompanied by all 27 of Brazil's state governors, he personally delivered to Congress long-awaited bills to reform pensions and taxes. These are crucial to containing the crippling public debt and improving the economy's performance.

What matters now is how many votes Lula can muster in Congress. Neither proposal is likely to pass unscathed. Both involve constitutional amendments, which must pass twice by three-fifths majorities in both the Chamber of Deputies and the Senate.

A lot can happen on the way. To mild surprise, Lula included a contentious clause to reduce the pensions of existing retirees, a measure demanded by the states to shore up their finances. This may be watered down—perhaps by raising the portion exempted from the new charge—or eliminated. Although that would denude the pension reform of much of its immediate fiscal impact, it would not trouble the financial markets much. “If they keep the rest, it's still meaningful,” says Carlos Kawall, chief economist at Citibank in São Paulo.

The tax bill is a hotch-potch, rather than a thorough overhaul. It would unify 27 different state value-added taxes and convert a separate tax on company turnover into a proper VAT. Though less controversial than the pension plan, the tax bill benefits some sectors at the expense of others, and may also be vulnerable to tampering.

The parliamentary line-up favours the reforms. Most of the opposition, though reluctant to give Lula an easy ride, will go along. Many of Lula's allies and part of his own Workers' Party (PT) are against, but they can be disciplined. This week, party leaders suspended three PT dissidents from lower-house committees vetting the pension reform. The congressional marathon will last the rest of the year, but should end in victory for Lula.

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Colombia's conflicts

Hostage to the FARC

May 8th 2003 | BOGOTÁ
From The Economist print edition

The murder of guerrilla hostages puts pressure on the president

Get article background

IT WAS a meticulously planned operation, Colombia's generals insist. After months of intelligence reports and six days of preparation, 75 of the army's most highly-trained soldiers descended from helicopters on May 5th to assault a camp in remote jungle where they believed that guerrillas from the Revolutionary Armed Forces of Colombia (FARC) were holding 13 hostages. But things went horribly wrong. When the soldiers reached the camp, nine of the hostages were already dead. On hearing the approaching helicopters, their captors had executed them and then fled without trace, according to three fortunate hostages who survived.

For Álvaro Uribe, Colombia's increasingly embattled president, it was a painful setback. Among the dead were the governor of Mr Uribe's home department of Antioquia, and a former defence minister. They were kidnapped by the FARC in April 2002 while leading a peace march. The other hostages were soldiers; most had been captives since 1998.

The FARC, an originally Marxist group now financed by crime, has been widely condemned for the murders. Its claim that the hostages were killed in crossfire is not believed. But the deaths will also intensify a debate on what the government should do about the FARC's remaining hostages. This issue was already rising up the political agenda. It is an especially difficult one for the government.

In 2001, Andrés Pastrana, Mr Uribe's predecessor, agreed to a prisoner swap, in which 363 FARC captives, many of them police and soldiers, were exchanged for 15 jailed guerrillas. Predictably, that encouraged the FARC to start kidnapping prominent politicians to use as bargaining chips. Apart from those who died this week, the guerrillas' captives include six congressmen, an ex-governor, and Ingrid Betancourt, a former presidential candidate with few supporters in Colombia but many in France, the country of her former husband. In addition, the FARC is holding three Americans captured when their spy plane crashed in February.

The hostages' families, supported by much of Colombia's political establishment, including several former presidents, have been pushing Mr Uribe to accept a FARC offer of a new prisoner swap. The president, who was elected on a promise to bring security to Colombia, believes such a deal would not only encourage more kidnapping but sap the army's morale (it would also discourage the army from taking guerrilla prisoners). So he has imposed tough conditions, which the FARC are unlikely to accept. These include UN oversight, the release of all the FARC's hostages (not just politicians), and the permanent transfer of any freed guerrillas to a foreign country.

But polls show that public support for a prisoner swap is rising. Last month, the government allowed emissaries to talk to some FARC leaders about the issue. Mr Pastrana's softly-softly approach to the FARC only hardened public opinion in favour of military action. And if this fails, as it did this week? Colombians tend to be fickle, and the FARC is expert at manipulating divisions of opinion. Mr Uribe must hope that his uncompromising stance does not leave him isolated.

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Canada's universities

Ontario's student bulge

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From The Economist print edition

What price a degree?

FOR Ontario's school leavers, the biggest headache this month is not the SARS outbreak apparently now over in Toronto, the province's biggest city. It is whether they are going to be awarded a place to start university in September. This year, the competition is abnormally tough. Ontario's Conservative government has decided to fall into line with other provinces, and do away with Grade 13, the final year of high school.

In its place, three years ago the provincial government offered its 19 universities an extra C$2.5 billion ($1.7 billion) to expand. Frantic building of laboratories and classrooms followed. For example, Carleton University, in Ottawa, is ready to take 5,700 students in September, up from 4,600 last year. It wants to hire 60 more teachers by July, and 40 temporary ones. It is tapping retired civil servants and businessmen who would like to teach for two or three years, says Stuart Adam, the vice-president for academic affairs. He hopes to keep the teacher-student ratio at 1 to 24.

Even without the Ontario student bulge, Canada's universities were straining to keep up with rising demand. Young Canadians appear to have listened to the government's preaching that prosperity depends on “the knowledge economy”. Over the past decade, university enrolment has increased by 20%, or more than 100,000; it is set to grow by another 200,000 in the coming decade. Enrolment is up even in provinces like Newfoundland whose population is declining. In Ontario, about 30% of young people between the ages of 18 and 24 already attend university, one of the highest rates in the country.

More does not necessarily mean better. William Leggett, the principal of Queen's University in Kingston, one of Ontario's (and Canada's) best, points to a growing “quality gap” with the United States, where an average university has one teacher for every 14 students. In Canada, most universities depend for most of their funds on provincial governments. Mr Leggett has called for Ontario to deregulate its universities, removing the cap on fee increases, as several provinces have done.

Opponents argue that students already pay a lot in fees and living expenses, and that fewer grants are available than in the United States. A four-year degree at Queen's can cost more than C$30,000; it charges $13,000 a year for medical school. But that has not prevented it from drawing students from far and wide.

Queen's is not adding to its 14,000 places this year. Less fashionable colleges in northern Ontario and in the Atlantic provinces hope for a windfall crop of students with better than normal grades. Ontario's bulge ought also to prompt a wider debate about university funding. But that looks unlikely.

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Transport in Mexico

Dreams of steam

May 8th 2003 | MEXICO CITY
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Tourist trains offer a faint hope of revival for a once-great industry

LOOKING for some peace and quiet in the mayhem of Mexico City? Try Buenavista, the main railway station. Once past the bored security guards, you are guaranteed silence and complete privacy. The last train departed in January 2001, carrying just two passengers.

When Mexico's railways were privatised a decade ago, the new owners opted to concentrate on freight. Passenger services, long unprofitable, were run down, and finally withdrawn along with government subsidies. Only tourist services on two scenic routes survived: the Copper Canyon railway in the north, and the “Tequila Express” near Guadalajara. But in a country that suffers poor roads, expensive airfares, and overcrowded city transit systems, interest in trains is reviving.

This is starting with more tourist routes. A new service links the Mayan ruins of Palenque with Mérida in Yucatán. An entrepreneur, Jaime de la Fuente Rivera, plans to start in September a service between the colonial silver towns of San Miguel de Allende, Guanajuato and Querétaro, in central Mexico. He has bought and restored several carriages of the old presidential train, complete with separate compartments for bodyguards. A new, two-tier, coach has a cinema and gym, aimed at American tourists.

Mr de la Fuente has received help from state governments, who have tarted up the stations and repaired some track. They want the tourist trade, but also hope the venture will encourage others to run normal passenger trains on the same routes, linking their cities with the capital on what was once one of the busiest stretches of the old national railway system. But this dream is an expensive one. With each passing year, the bill to repair old, unused, track mounts. A fast train would probably need new track anyway, costing perhaps $500m for the 220km (140 miles) between Mexico City and Querétaro alone.

A likelier scheme is for the federal government to join forces with the Mexico City mayor to start running suburban trains from Buenavista station, maybe in 2006. If the price was low enough, commuters would be happy. So would the skeleton crew left to sweep the platforms at Buenavista in the hope that the

trains might one day run again.

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India and Pakistan

A third and final chance

May 8th 2003 | DELHI
From The Economist print edition

The Indian prime minister's bold appeal for peace needs to produce results quickly

Get article background

THE thrill was palpable after the unexpected announcement on May 2nd by Atal Behari Vajpayee, India's prime minister, that he wanted to start a “decisive and conclusive dialogue” aimed at ending the decades of hostility between his country and Pakistan. Zafarullah Jamali, Pakistan's prime minister, smartly responded with a ten-minute telephone call to Mr Vajpayee, and a letter which talked about curbing terrorism and proposed a summit in Islamabad. Colin Powell, America's secretary of state, saw a “moment of opportunity where both sides seem to be reaching out.” Not to be outdone, General Pervez Musharraf, Pakistan's president and Mr Jamali's boss, weighed in, dusting off old ideas for a non-aggression pact and the de-nuclearisation of the subcontinent.

Suddenly it seemed that these two nuclear powers might be on the verge of substantive talks. By the middle of this week, however, they were already bickering over the details, underlining the sad truth that an early summit is unlikely, and that it could be years before real progress is made. But even such squabbling is an improvement on the stand-off that developed after India blamed Pakistan for helping to facilitate terrorist atrocities, including a suicide attack on its Parliament in December 2001. The main advance is that, as suggested by Mr Vajpayee, both countries are to reappoint high commissioners (the Commonwealth's equivalent of ambassadors) to each other's capitals; and it looks as if air links may be resumed soon.

America insists that the Vajpayee initiative came as a pleasant surprise, not least for Richard Armitage, the deputy secretary of state, who has been in the region all this week on what was planned as a damage-limitation exercise. There have been fears for months that a fresh terrorist attack in India might lead to more sabre-rattling and possibly a border confrontation. At the end of March, both countries tested nuclear-capable missiles a day after India blamed Pakistan for the massacre of 24 Hindus in Kashmir and the assassination of a local moderate political leader. Instead, Mr Armitage's job now has been firstly to encourage Pakistan to respond positively to Mr Vajpayee, while curbing its support for cross-border terrorism in Kashmir, and secondly to urge India to be patient in its dealings with its neighbour.

In part, both countries have been taking up positions that would put them in a good light before meeting

Mr Armitage. In the case of Pakistan, General Musharraf's meeting with President George Bush in Washington next month will also have played a part. But the Indian moves go deeper. They were taken on the personal initiative of Mr Vajpayee, who stunned his listeners on May 2nd when he told the Indian Parliament that he was launching his “third and final” effort for peace. His earlier efforts, in February 1999 and July 2001, had ended in failure that did his image no good at all.

But at 78, Mr Vajpayee, a former foreign minister, wants to carve out a niche in history. Indian diplomats say he believes the international situation has changed since the Iraq war, and that India and Pakistan are obliged to make a fresh bid for peace. Mr Vajpayee also felt that India had painted itself into a corner by refusing to talk to Pakistan until it had put a complete end to cross-border terrorism, and that this stance could not be sustained indefinitely.

Mr Vajpayee consulted very few cabinet colleagues before his statement on May 2nd. He went ahead despite the scepticism of senior ministers such as L.K. Advani, the deputy prime minister. Leaders of his Bharatiya Janata Party (BJP) also oppose the initiative, partly because they do not believe anything will be achieved, but mainly because they want to play up what they believe are vote-winning fears of Pakistan-aided terrorism during state elections this autumn and in a general election next year. But Mr Vajpayee's stature is such that opposition has melted away in the past week and, for now, he is free to pursue his initiative, supported even by the Rashtriya Swayamsevak Sangh (RSS), the BJP's hardline-Hindu sister organisation.

However, the BJP will quickly lose patience if the initiative does not yield results. These need to include a demonstration by Pakistan that it is serious about stopping terrorists crossing into Kashmir and about closing down their support facilities on its side of the border. India realises that General Musharraf cannot control the terrorists completely. Yet 156 people have been killed (103 militants and 53 Indian forces and civilians) since Mr Vajpayee's trip to Srinagar on April 18th, when he held out “the hand of friendship”.

So far, Pakistan's responses have not been sufficient for India to go beyond restoring ambassador-level relations and perhaps air links, though Mr Jamali did say last weekend that Pakistan would not insist on focusing first on resolving the Kashmir dispute. India criticised proposals by Mr Jamali on May 6th for not going far enough on removing restrictions on trade, and for saying nothing significant on cross-border terrorism.

That gives some idea of the dimensions of Mr Powell's “moment of opportunity”. As Mr Armitage said when he was asked by the BBC about the prospect of the region becoming nuclear-free, “let's keep our appetites under control”. Rightly said.

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Japan

Trickle-down pain

May 8th 2003 | TOKYO
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Will Japan's small firms sink the government's latest reform effort?

Get article background

IT MAY not create many new jobs or start-up companies, but Japan's sick economy continues to spawn new government bodies. The newest, the Industrial Revitalisation Corporation (IRC), officially swung into action on May 8th. The IRC will borrow up to Y10 trillion ($84 billion) over the next two years, purchase the debts of perhaps several hundred ailing companies, and then try to turn them around. Yet while the IRC will have to focus on biggish companies to matter, it may soon fall foul of the many small firms that have undermined reforms in the past.

Politicians and bureaucrats have long squabbled over whether weak companies should be allowed to sink, be kept afloat collectively through looser fiscal or monetary policy, or be tided over in more selective ways. The IRC represents an attempt to help selectively. The government's sales pitch is that turning some companies around will improve the banks' balance sheets, generate some optimism in the economy, and make it easier to take tough action with the remaining, bad borrowers.

Some optimists say that the IRC may succeed where similar efforts failed in the past because, this time, new rules have been imposed on banks as part of the policy package crafted last October that led to the IRC's creation. This, say hopeful reformists, will prompt weak borrowers who fear losing their credit lifelines to go voluntarily to the IRC, and accept tough changes in their business practices. Still, there are many reasons to remain sceptical about the IRC's prospects, including the failure of so many past promises regarding banks and their balance sheets. As a test of how the IRC is doing, one thing to watch will be the effect that it has on small companies and the way that politicians react.

Even if the IRC begins to work roughly as planned, and some viable companies do volunteer for its help, serious attempts to “revitalise” those companies will probably require them to inflict pain on countless smaller firms. The problem is especially severe in sectors such as construction and wholesaling, where tiny suppliers depend on giant and heavily indebted companies downstream. Even in more hopeful sectors, however, such as electronics or other types of manufacturing, cutting costs will have to be part of any solution for troubled firms. The best hope for many consumer electronics firms and other manufacturers is to shift more of their production to places such as China.

Some of the shakeout has already started to happen, as bankruptcies have risen to around 19,000 firms a year. But most economists reckon that many more firms would go bust, and that unemployment would shoot up much higher than the current level of 5.4%, if big and troubled companies ever got serious about boosting efficiency.

Ulrike Schaede, an economist at the University of California in San Diego, argues that this is the main reason why so many of Japan's supposed reform efforts continue to fail. In a forthcoming paper for the *Harvard Asia Quarterly*, she argues that “with every reform measure comes a counterbalancing quasi-welfare measure that impedes true reform.”

If the new IRC does not end up putting lots of small firms out of business, then it will either be working with too few big companies to make much difference or it will be letting those companies get away with half-measures. And if it does start cutting small suppliers loose, the politicians will scramble for a way to stop it.

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China

Not such a threat after all

May 8th 2003 | BEIJING
From The Economist print edition

The SARS outbreak and the internet

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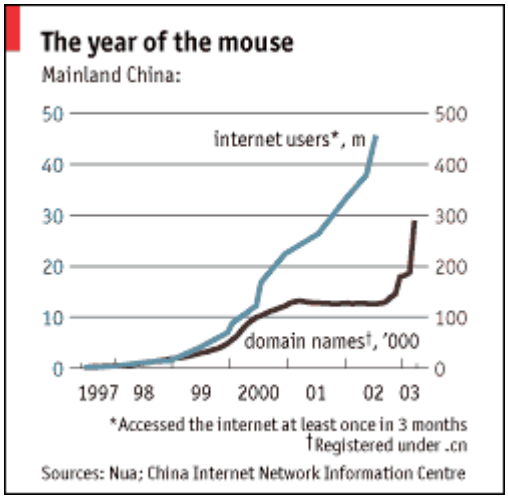

WHATEVER the outcome of the Chinese government's battle against the respiratory disease SARS, the crisis has demonstrated its ability to coexist with what many once regarded as a no less insidious threat, albeit a political one: the spread of uncensored information through the internet.

In the past few days, official newspapers have reported dozens of cases of citizens being punished with fines or brief periods of detention for spreading “harmful” rumours about SARS, using mobile phones or computers. According to one report, the police in Guangdong province, where the disease first surfaced, calculated that more than 2.16m instant messages containing SARS rumours were exchanged by mobile phones in late April.

But the government's decision on April 20th to come clean about the extent of the epidemic—as well as its unusual admission on May 2nd that a submarine accident had caused the deaths of all 70 people on board—were not the result of any pressure from the flow of independent information through these new media. In Beijing, 82% of people have a mobile phone and more than 55% of households have computers, but there is little evidence that the wealth of information about SARS available on the internet—much of it critical of the government's handling of the crisis—has had much impact on public behaviour either.

Although China admitted to a handful of cases in Beijing on March 26th, it was not until the government's volte-face on April 20th that most Beijing residents began showing signs of alarm about the disease. Suddenly, mask-wearing became the norm—even though the internet had been awash with reports for the previous couple of weeks of a massive cover-up of SARS cases, including credible testimony to this effect by a semi-retired senior doctor at a top military hospital. The doctor's daring challenge to the government's lies about SARS may have helped to prompt the leadership to become more open. But the availability of the doctor's account on the internet did not.

Though the internet and mobile telephones were virtually unheard of during the capital city's last big crisis—the Tiananmen Square protests of 1989—independent information was nonetheless freely available even then. Many citizens tuned into shortwave news broadcasts from overseas. The internet has brought added convenience, but has not obviously changed the public's level of awareness. Indeed, the increasing liveliness of the government-controlled media may have diminished the public's thirst for alternative sources.

What prompted the government to reveal the submarine accident (though only the barest of details were given) is still a mystery. Some diplomats in Beijing speculate that it could involve a power struggle between Hu Jintao, China's newly appointed president and Communist Party chief, and his predecessor, Jiang Zemin, who remains in control of the armed forces. According to this theory, Mr Jiang was embarrassed into revealing the incident as a result of a push by Mr Hu for openness in the handling of SARS. If the party does face a threat to its grip on power, it would most likely arise from struggles such as these.

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Uzbekistan

Freedom for a day

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From The Economist print edition

A breath of fresh air in a repressive land

THE decor was festive in Tashkent last weekend. Snakes of lights coloured the streets, and banners offered a warm welcome to the hundreds of foreign officials, journalists and members of NGOs who arrived in Uzbekistan's capital for the annual meeting of the European Bank for Reconstruction and Development (EBRD).

Until a few weeks ago, though, it looked as though the meeting might be held elsewhere. The EBRD's choice of venue has been heavily criticised. The bank's mandate is to help countries committed not only to the free market, but to multi-party democracy, the rule of law and human rights. Yet Uzbekistan's government is one of the most repressive in the region, with over 6,500 religious and political prisoners, and no opposition or press freedom to speak of. Despite some largely cosmetic moves, such as the registration of two human-rights NGOs, Britain's ambassador to Uzbekistan said in October that there was little sign of substantive change over human rights.

AP

Karimov did not condemn torture

So the EBRD has been at pains to state that holding the meeting in Tashkent was not an endorsement of the government's policies. It has given the government one year to improve its record on human rights and political reform, failing which it will stop financial support. The bank also hoped that holding the meeting in Uzbekistan would result in more openness. The opening session on May 4th, on “investment climate”, offered a platform for local human-rights activists to complain about the situation in the country. A small group of protesters assembled outside the meeting. Islam Karimov, the country's president, told the delegates that Uzbekistan attached great significance to promoting the role and work of NGOs. Clare Short, a British government minister, said she was concerned about the lack of respect for freedom of religion, the prevalence of torture and the failure of the judicial system to protect the rights of the citizen. Jean Lemierre, the EBRD president, spoke of his regret that Mr Karimov's speech did not emphasise the importance of human rights.

After arduous negotiations by the EBRD, this opening session was transmitted live on local television. So local viewers at least had a chance to hear an alternative view of Uzbekistan's record. By Uzbekistan's standards, this may be progress. But it is likely to be largely lost on most Uzbeks. For days before and after that broadcast, the event has been presented by the local media as a stamp of approval for the country's policies. The main television channel informed its viewers that countries wishing to receive assistance from the EBRD should meet democratic standards and that the fruitful co-operation between Uzbekistan and the EBRD showed that Uzbekistan had gained a great deal of trust in this respect. There was not a word about the EBRD's conditions for continued financial support, or the fact that the IMF, after meeting with Uzbekistan government officials before the meeting, is still withholding financial assistance.

Mr Lemierre had been confident that Mr Karimov would publicly condemn torture, one of the first recommendations of a United Nations representative during his speech. He did not. Human Rights Watch, a New York-based NGO, reported that human-rights activists and relatives of religious prisoners were harassed in the wake of the meeting, and that some NGO representatives were intimidated by officials even during the forum. The ultimate test will be what happens after the lights are down and the foreign guests have gone. The review of the conditions, a year from now, will provide another occasion to bring Uzbekistan into the spotlight and to test the EBRD's seriousness about its mandate. The government,

however, insists that it needs to approach economic and political reform in its own way and at its own pace. One year may prove to be far too short for that.

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Aceh and Papua

Loose ends

May 8th 2003 | JAYAPURA
From The Economist print edition

Indonesia's unmanageable provinces

WITHIN the next few days the Indonesian government, so it says, will scrap negotiations with separatist guerrillas in Aceh province, and go back to war—unless the rebels agree to rewrite the framework peace deal the two sides signed in December. At the same time, at the other end of the enormous Indonesian archipelago, the government is undermining the special form of autonomy it granted to Papua, another restive province. Its handling of the two trouble spots is seen as a test of whether it can defuse Indonesia's many internal conflicts and, in the long run, hold the country together. So far, it is failing.

The bloody separation of East Timor from Indonesia in 1999 stoked fears that the country might gradually disintegrate, as one wayward region after another broke away, starting with Aceh and Papua. Successive governments have used both carrots and sticks to ward off this outcome. B.J. Habibie, the president at the time of the East Timor breakaway, preserved the policy of military repression that had enflamed separatist feelings in both provinces in the first place. Abdurrahman Wahid, his successor, favoured the carrot: he tried to placate both Aceh and Papua with an enhanced form of regional autonomy, which allocated 80% of revenues from natural resources to the governments of the two provinces, and sought to appease local sensibilities. In Aceh's case, that meant the right to institute Islamic law; in Papua's it meant the creation of the Papuan People's Council, a panel of religious, tribal and female leaders designed to defend the interests of indigenous Papuans.

For a time, Megawati Sukarnoputri, the current president, also favoured friendly tactics. She supported last December's agreement with the Free Aceh Movement (known by its Indonesian acronym, GAM). The police and courts began an unprecedented series of investigations into military abuses in Papua. But in recent months, Miss Megawati has switched to the stick. The government began dragging its feet about the Aceh accord, and sent extra troops to the province. It also sent soldiers from Kopassus, the army's special forces, back to Papua, even though the unit was implicated in the murder of Theys Eluay, a separatist Papuan politician.

But the step that has provoked the most resentment in Papua is a recent presidential decree ordering the division of the province into three. Critics say the decree aims to divide the independence movement, to co-opt educated Papuans into an expanded bureaucracy and create new political fiefs for the president's party. The government says it is merely implementing a long-standing law aimed at improving the administration of the province. If so, it has achieved the opposite: nobody knows who is running the different parts of Papua, nor whether the autonomy law still applies.

The province is certainly receiving lots of extra revenue, in keeping with the autonomy law. But indigenous Papuans, who are poorer, less educated and less healthy than other Indonesians, complain that they have not benefited at all from this windfall. Instead, one indigenous politician fumes, provincial bureaucrats have wasted it on new four-wheel drives for themselves and fact-finding missions to Europe. In theory, the Papuan People's Council should guard against such abuses. But the government has prevented it from convening by failing to produce the necessary regulations. Now, say officials at the Ministry of Home Affairs, the matter will have to wait yet longer while they decide whether one council is needed or three.

Most indigenous leaders argue that this shambles has destroyed Papuans' faith in autonomy, and strengthened their desire for independence. However, they caution, the independence movement cannot hope to defeat the Indonesian armed forces and so will not resort to violence. They claim that apparent separatist attacks, such as a recent raid on a government arms depot, are actually instigated by the army to justify its own presence.

As for Aceh, the government, which agreed to an “all-inclusive dialogue” last December, now wants to exclude any talk of independence. It also wants GAM to disarm before it reins in the army, rather than simultaneously, as envisaged in December. GAM has already rejected both demands, and insisted on sticking to the original deal. The stage is set for a return to fighting, which has claimed some 10,000 lives over the past decade. Andi Mallarangeng, a politician who helped draft the special autonomy law, gloomily concludes, “Megawati is supposed to be thinking about the unity of Indonesia, but her actions are breaking the country apart.”

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The Philippines

No peace, no peace talks

May 8th 2003 | MANILA
From The Economist print edition

After the latest outrage, Mrs Arroyo gets tough

Get article background

WHEN guerrillas of the Philippines' biggest Muslim rebel group, the Moro Islamic Liberation Front (MILF), raided the southern town of Siocon on May 4th, President Gloria Arroyo called it terrorism. The army said that about 70 guerrillas had attacked public buildings and used civilians as human shields as they withdrew. At least 34 people, many of them civilians, were killed. The MILF said the guerrillas' target was a military headquarters, and that they did not intend to harm civilians.

Mrs Arroyo reacted by postponing indefinitely peace talks that had been due to begin on May 9th. The government offered a reward of 50m pesos ($956,000) for the capture of the leaders of the MILF, and said punitive action would be taken against the guerrillas who mounted the raid. Mrs Arroyo said peace negotiations could resume when the atmosphere was more conducive. But her more aggressive attitude to the MILF reflects a shift in the balance of influences in her administration.

Some members of Mrs Arroyo's government wish America to classify the MILF as terrorists. America is already giving generous military aid and training to help the Philippines eradicate a much smaller group of armed Filipino Muslims, Abu Sayyaf, whom it already regards as terrorists. Adding the MILF to the list would keep the Philippines in the front line of the war on terrorism. The hawks in Mrs Arroyo's administration think that extra American help would enable the armed forces to finish off the Muslim rebellion.

So far, Mrs Arroyo has tried to dissuade America from labelling the MILF as terrorists. But the Siocon raid has weakened the influence of those members of her government who argue that negotiations are the only way to make peace. For more than three decades, guerrillas have been fighting to gain independence for the Muslim minority in the south of this mainly Christian country, and all attempts to end the rebellion by force have failed. The doves say that economic progress will in time remove the inequities at the root of the rebellion.

In spite of the postponement of peace talks, the MILF said it was still willing to negotiate. For the time being, the government is gambling that increased military pressure on the guerrillas will make them return to the negotiating table suitably chastened, and ready to talk peace more earnestly.

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Post-war Iraq

Out of the ashes

May 8th 2003 | BAGHDAD
From The Economist print edition

AP

Anxieties and fears prevail, but confidence is growing

Get article background

WAR will be the easy part, was a warning often sounded before the invasion of Iraq. But just how difficult the country's recovery would be is only now becoming clear.

Jay Garner, the ex-general charged with overseeing Iraq's rehabilitation (but who will be junior to Paul Bremer, George Bush's new appointee who was once head of counter-terrorism at the State Department) said that an interim ruling council, dominated by broadly-based opposition figures, should be in place within a month. Iraqi politicians, when cornered between endless rounds of meetings, insist they are progressing towards the creation of a 300-person National Assembly. This body would be empowered to draft a constitution, create a judiciary—and legitimise a cabinet that would be both sponsored and advised by the Americans.

Courts are beginning to function again. Some schools have re-opened, and universities are scheduled to re-start next week. Further comfort comes from an announcement that there is enough money in state coffers to pay salaries at some point, and enough reserve to keep the currency afloat. The Iraqi public can now read such good news in any of the dozens of party newspapers being printed in Baghdad.

But, so far, the stronger impression of freedom has been of anxiety and insecurity. Leftover ordnance from the war continues to inflict hideous casualties, particularly on children. Daily life is plagued by frustrations such as late or no salaries, shortages of cooking gas so severe that its price in some districts is pushing 60 times pre-war levels, and mile-long queues for petrol. This week, a cigarette dropped at one jammed filling station sparked a conflagration that killed 17 people.

A month after the capital's fall, looters are still at large. Public buildings continue to smoulder, although the fires now seem limited to what the former regime would have thought of as strategic institutions, such as the Ministry of Military Industries. To some, this hardens the suspicion that Baathist saboteurs, bent on covering their masters' tracks and on embarrassing the occupiers, have had a hand in much of the destruction in Baghdad and elsewhere. Their presence remains a serious worry, not just to American forces but also to ordinary Iraqis.

For example, seized Baath Party documents shown to this correspondent at Falouja, a place still tense

after last week's deadly clashes between residents and American soldiers, reveal the huge scale of pre-war arms distribution. In a town of barely 60,000 inhabitants, the handouts to party officials included 3,000 Kalashnikovs, along with assorted pistols, mortar bombs, machineguns and sniper rifles.

It is not just the firepower stashed in homes that raises fears. The absence of telephones, television and radio has crippled opposition parties' efforts to organise. It has also stymied American attempts to put across the message that they are here to help, a message in any case muddled by crossed signals coming from different parts of the American administration. By contrast, the Baath Party has maintained much of its membership network in large parts of the country, and therefore much of its power to persuade and intimidate.

Return of the bosses

Mr Garner's office, ensconced behind tanks and barbed wire in the vast Republican Palace compound, has encouraged Iraqi functionaries to return to their jobs. The idea is to get institutions working quickly, but because membership in the party was the only guarantee of promotion, Baath loyalists still pack the bureaucracy, most thickly in the top ranks.

However competent, many are loathed by co-workers. Employees at different institutions, from hospitals to local government offices, have pleaded with this correspondent to tell the Americans not to bring their old bosses back. The Americans say it is not their job to choose or fire Iraqi officials. That is a task for the interim Iraqi government. Reasonable, perhaps, but such prevarication disturbs precisely those Iraqis who are best disposed to the invaders.

The sacking and vandalisation of much of the country's cultural heritage in the aftermath of war has also badly dented American prestige. Rumours, echoed on the Iranian television that is still the only fare for most Baghdadis, insinuate American complicity, perhaps with the use of Kuwaiti agents. But other rumours speak of a plot by the outgoing regime, or perhaps schemes to cover up pilfering over the years by former officials.

Whatever the real motive, virtually every museum in the country lost all or part of its collections. The national library and film archives are completely gutted. Torn-out title pages of books being flogged on street corners, for as little as ten cents each, suggest malign provenance.

Yet the damage has in many cases not been quite as severe as initially reported. Nearly all the 40,000 manuscripts at the Saddam Centre, for example, had been moved to safe storage, say employees. Volunteers protected the main library of Baghdad University from pillagers. The faculties of agriculture, literature and veterinary science were all ransacked, but other departments were spared. Stolen artefacts have trickled back to local mosques, deposited by repentant looters or by honest citizens who snatched them to protect them from real thieves.

“If we have lost our ancient treasures, we will create new ones,” says an actor, Bassem al-Tayeb, revelling backstage after the success of a play where he played the role of a mythical tyrant. The performance, in the bombed and burned wreck of Baghdad's premier arts theatre, the Rashid, amounted to a celebration, not of liberation from dictatorship, but of the triumph of the artists' free spirit through both oppression and invasion. In the past, the troupe of young actors had been thwarted by party hacks from staging plays as innocuous as Hamlet.

On Mutanabbi Street, a book market named for an irreverent medieval poet, Samizdat publications that once earned prison, torture or worse now trade freely. “If people don't look happy its because they have never tasted the sweet things in life,” says Shaalan Zeidan, a bookseller. “They are coming out of a tunnel so long and dark they can't recognise light.”

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Iraq's stolen antiquities

To catch a thief

May 8th 2003
From The Economist print edition

Retrieving the objects will be, at best, complex and lengthy

Get article background

Reuters

A stolen head returns home

AT A meeting this week in Lyons, the headquarters of Interpol, John Ashcroft went a little way towards calming the fear that the United States had adopted an insouciant attitude to the looting of Iraq's museums. The words of Donald Rumsfeld, the secretary of defence, who notoriously dismissed it as “stuff happens” carry greater weight, but the attorney-general called the looting, which the American marines in Baghdad had done nothing to prevent, “an assault on the values of civilisation...US law enforcement...will not rest until the stolen Iraqi artefacts are returned to their rightful place.” He also sided with the view that the theft had been steered by organised criminal groups who knew what they were looking for.

Requests for co-operation have been bouncing between and within governments. America's stance is crucial. The chairman and several members of its influential presidential advisory board on cultural property resigned in protest at the looting in Baghdad, and a new board is due to be appointed. Many people see the incoming board as tilted towards the rights of collectors, and this leads experts to fear that America may be considerably too relaxed about the return of Iraqi property.

A Unesco convention bars the import of artefacts from museum collections. The snag is that clear documentation showing the object's provenance is usually required before any action can be taken, and with inventories destroyed or missing, the business of cataloguing the stolen objects looks like being an extremely slow business. The statement at the end of this week's Interpol conference recognised that Unesco should take the lead in collecting and co-ordinating information. Interpol and Unesco would together determine when and how the resulting database would be made available to museum professionals, art dealers and the general public. In the meantime a “red list” drawn up by the International Council of Museums would have to suffice.

America has now sent military and customs investigators to Iraq, and FBI agents may follow. A number of items have already been handed in; the Americans say their teams have recovered 700 artefacts. Interpol is being urged to police Iraq's borders and ports, and there are calls for a UN-sponsored moratorium on all trade in Iraqi antiquities.

To get anywhere, the co-operation of Iraqi curators and archaeologists is considered essential. But indiscriminate de-Baathing could cripple the Antiquities Department. The difficulty, here and elsewhere, is drawing a balance between cleansing the regime and losing experience and knowledge.

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Cluster bombs and Iraq

The lethal detritus of war

May 8th 2003
From The Economist print edition

Unexploded bombs are still killing a great many people in Iraq

AP

The shiny casing was so attractive

Get article background

THE newest cluster bombs sound too good to be true. Small bomblets emerge from their casing as they hurtle towards the earth, whereupon sensors guide them to tanks and other targets, as mini-parachutes slow their descent. If the bomblets fail to find something suitable to destroy, they automatically self-destruct.

Too good to be true, indeed. Even some of the newest bomblets deployed by America and Britain have malfunctioned, says the Mines Advisory Group (MAG), which is working to clear up unexploded ordnance in northern Iraq. Along with the rest of the detritus of war—bomblets from older devices, Iraqi landmines left over from successive conflicts, and vast stockpiles of abandoned weapons left unguarded by Iraq's new occupiers—they are killing and maiming those unfortunate enough to stumble upon them.

These casualties tend to peak in the weeks after a war, explains Richard Lloyd, of Landmine Action, a campaign group, as people return to places that they had wrongly assumed to be safe. Sean Sutton, of MAG, says that there have been hundreds of casualties in the north since the hostilities ceased, around half of which have been children. Landmines—trickier to spot than cluster bomblets—are the biggest problem, though the latter's shiny casing fatally attracts youngsters.

Cluster bombs have a long and controversial history. Most of the individual bomblets—dozens or hundreds of which are contained in each bomb—fall haphazardly over wide areas, and some fail to explode; the self-destruct mechanisms on the newer models have reduced the risk, but not entirely. Advocates argue that the weapons are useful against broad targets, such as runways, armoured columns and troop concentrations. America says it dropped 1,500 of the things in Iraq for these purposes.

Human Rights Watch, a lobby group, says that the figure is misleading, because it does not include munitions fired from the ground. America admits to using them in civilian areas, but says they struck only 26 targets within 1,500 feet of civilian neighbourhoods. For their part, the British fired around 2,000 cluster bombs from the ground, and the Royal Air Force dropped another 65, mostly around Basra.

America and Britain both say that they will help to clear up the deadly mess they have left, but others say they have been slow in disclosing what they dropped and where. The question remains whether the use of cluster bombs, old or new, in civilian districts, violates the rules of war.

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Baghdad's hospitals

The battle for medical real estate

May 8th 2003 | BAGHDAD
From The Economist print edition

Should Iraq's new clerical militia, or the old Baathist managers, run hospitals?

Get article background

FACED with insurrection in the ranks, Saddam Hussein's former health officials are fighting back. With American help, Iraq's newly reopened Ministry of Health is cancelling the elections of hospital administrators that had been organised by doctors and members of the clerical militia in the void that followed the fall of Baghdad. Instead, they are reconstituting the *ancien régime*. According to doctors at Baghdad's Al Wiya maternity hospital, American tanks parked at the hospital gates were prepared to defend the return of Muhammad al-Taweel, who had been voted out as manager, the job he had held since Mr Hussein came to power. The doctors and the clerics melted away, and back came Mr Taweel's bodyguards.

“Some ignorant doctors misunderstood democracy,” says Mr Taweel, who ascribes the allegation he was pocketing hospital fees to professional jealousy. He was never a Baathist, he says, but rather survived on merit after pioneering test-tube babies in Iraq. Support staff, resembling bouncers, sit at his side. He has recast himself as a *sayid*, or scion of the Prophet Muhammad, and spices his speech with the sayings of the Shia founders.

Some 21 discoloured patches scar the walls where photos of Mr Taweel at the side of Mr Hussein once hung. But down the corridor Saddam's stencilled moustache pokes through the whitewash like a shadow. “We still can't talk,” whispers a doctor. “We feel Saddam is still with us.”

Another Baghdad hospital, the Al Kindi, is still resisting, in its way. Shia squads wrested control of the hospital, and supervised elections for a new management board with a show of hands. “Do what the Hauza [the Shia seminary in Najaf] tells you,” instructs a sign over the entrance. The 30-year-old director, Sheikh Abbas al-Zubeidi, has six years' training, not in medicine but in religious studies.

His authority, he says stroking a pistol, comes from a letter of appointment from the office of an ayatollah's son at Najaf's Hauza. “We arrested 50 looters inside the hospital and made them repent by giving blood,” he adds. He is cutting corners fast: fees have been reduced for operations; a single doctor works the afternoon shift in casualty, seeing a patient a minute.

To cut off the clerics' supplies, NGOs say they have been ordered to stop the delivery of medical goods, and the provision of health care, without prior authorisation from the Ministry of Health. “Hospital directors said they had received the instructions from the Americans,” says Pierre Boulet Desbareau of Médecins Sans Frontières, who has teams of surgeons on standby. “There's a crisis, and the aid agencies are denied an emergency role.”

But, so far, the informal embargo shows only partial signs of working. Mosques are stocked with hospital loot, after an appeal by the clerics to Baghdad's pillagers to deposit the stuff they had stolen. Aid workers suspect that some imams were complicit in raids on army hospitals to strip anything from morgue refrigerators to white coats in an attempt to improve standards for their own communities.

The clerics claim that five of Baghdad's 34 hospitals remain in their hands. On at least one occasion, clerical militias are reported to have repelled rivals with bullets, forcing patients to dive under their beds. However, at Saddam General, a hospital in the heart of the Shia sprawl of slums north of Baghdad, the clerics recognised their inexperience and invited back the manager, who happens to be a Christian.

It is not just the young sheikhs who use security as a pretext to take control. In another Baghdad

hospital, Al Wasiti, American troops commandeered a renovated wing, due to be opened last month. Patients and the pharmacist were consigned to the hospital lobby, as the soldiers cleared the way for a barracks.

In this squabble for medical real estate, Iraqi doctors, nurses and patients are the losers. Doctors and nurses are failing to turn up for work, either because they fear for their security or, more probably, because whoever is in charge has omitted to pay them anything, even for the fare to get there. The American Office for Reconstruction and Humanitarian Assistance boasts of paying the 36 staff at the zoo, but tens of thousands of medical staff have yet to receive a $20 handout the Americans promised last month. “I've nothing left for the bus ride,” says a surgeon.

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South Africa's foreign policy

Come, let's be friends

May 8th 2003 | JOHANNESBURG
From The Economist print edition

Diplomacy may be a bit less quiet under the Mbeki doctrine

BUSY days, these are, for South African foreign policy. Last week, ex-President Nelson Mandela and two senior ministers presided over a change of president in Burundi. On May 5th President Thabo Mbeki, together with the rulers of Nigeria and Malawi, visited Harare for separate talks with Robert Mugabe and Morgan Tsvangirai, the opposition leader, about ending Zimbabwe's woes. Later the same day, Mr Mbeki shuttled to Kinshasa, Congo's capital, to talk to President Joseph Kabila about sharing his power with opposition groups. Although not much may come of any of this, Mr Mbeki is on the hunt.

Foreign policy is the president's main interest, at least in this, his first term. A Mbeki doctrine is emerging. It goes like this: South Africa cannot impose its will on others, but it can help to deal with instability in African countries by offering its resources and its leadership to bring rival groups together, and to keep things calm until an election is safely held. Mr Mbeki argues that the model of peace, power-sharing and reconciliation that worked in South Africa between blacks and whites a decade ago can be applied elsewhere.

Burundi does not carry much personal interest for Mr Mbeki, but it is furthest along his doctrine's track. An agreement between Hutu and Tutsi rivals was partly brokered by Mr Mandela and by Jacob Zuma, South Africa's deputy president, and over 600 South African soldiers already act as the politicians' bodyguards. Since nobody believes Burundi's troubles are really over (see article), more foreign troops, including three battalions of South Africans, are likely to be deployed, absorbing almost all the soldiers at Mr Mbeki's disposal.

Ending Congo's enormous problems is close to Mr Mbeki's heart; peace here, he argues, would boost economic development in the region, and show the world that Africa can solve even its biggest wars. Last year South Africa was host at two months of talks between Congolese factions, at a cost of some 150m rand (nearly $20m). It then brokered a deal under which Rwanda began withdrawing its soldiers from Congo. On April 8th, Mr Mbeki organised another summit, in Cape Town, to smooth relations between the presidents of Rwanda, Uganda, Tanzania and Congo. The strategy has been to get as many actors “inside the tent” as possible.

South African security agents are operating inside Congo, helping the UN to check whether foreign soldiers really leave. Mr Mbeki used his evening trip to Kinshasa to talk to Mr Kabila about the transitional government that is due to be installed on May 28th, and about power-sharing in parliament and in the army.

Zimbabwe will be a crucial test of Mr Mbeki's doctrine. A senior South African official, who observed some of the talks in Harare, insists that Mr Mbeki is becoming more involved, and even believes that a tiny bit of progress was made. Mr Mugabe tried to stop the visiting presidents from seeing Mr Tsvangirai, but was overruled. Mr Tsvangirai still will not recognise Mr Mugabe as president, but agreed to accept him as the country's de facto leader.

Until now, Mr Mbeki has preferred to deal with his neighbour with “quiet diplomacy”, a euphemism for inaction. But with some signs of success in Burundi and Congo, he may be bracing himself for more vigorous action in Zimbabwe, pushing at least for talks. That will be the day.

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Burundi's elusive peace

Shadows on the wall

May 8th 2003 | RUYIGI
From The Economist print edition

The presidency rotated, as ordered, but the people are still fearful

AS DARKNESS falls on Ruyigi, a garrison town in eastern Burundi, a chorus of mooing and clattering hooves indicates that night-time Tutsi fugitives are seeking safety. Besides their herds, most of them have a bundle of clothes, a cooking pot, or an umbrella to preserve from the Hutu rebels who haunt the hills outside. One sweat-drenched drover lurches like a drunk, a wooden double-bed see-sawing across his head. Burundians may be praying that their decade-old, tribally-based and particularly vicious civil war is about to end, but few of them are counting on it.

On April 30th, Pierre Buyoya, the leader of a clique of the minority Tutsi tribe which has ruled Burundi for 40 years, ceded the presidency to Domitien Ndayizeye, a Hutu. The changeover followed the terms of the Arusha accord, a deal brokered by Nelson Mandela between Mr Buyoya and various Hutu opposition groups. But the two biggest Hutu rebel groups were excluded from the deal, and despite subsequent peace efforts, they remain outside. Last month, one of the groups, the Force for the Defence of Democracy (FDD) showered Bujumbura, Burundi's capital on the shores of Lake Tanganyika, with over 100 mortars.

AFP

Can Ndayizeye show he's not a stooge?

Mr Mandela, who put in a weary appearance at the handover ceremony, has been criticised for failing to recognise the rebels as the true power in the Hutu camp. Yet, with a ceasefire signed between the government and the FDD last December, this was a gamble that nearly paid off.

According to the vague terms of the ceasefire, the army and the rebels were both to disarm, with the rebels to gather in independently-monitored encampments, where they would be fed with western food-aid. Alas, the EU food arrived, but not the joint UN-African Union team supposed to monitor the process. In its absence, the FDD began grabbing territory. In January, the army fought back in the way it knows best: massacring scores of Hutu villagers around Ruyigi. The rebels then rejoined the fray, shelling Ruyigi and other garrison towns, murdering Tutsis nearby.

Power, not ethnicity

Now both sides are predicting much heavier fighting. The army accuses the FDD of planning a new front across the country, east to west, with the aim of driving the Tutsi ruling class—including virtually all of its officers—into the lake. The FDD's elusive leader, Peter NkuruNziza, denies that the group's recent strategy amounts to a blueprint for genocide. “The war is not about ethnicity. That is not the reality of Burundi,” he said, in a moment of startling veracity while on a fund-raising drive in Gabon. “It's about power.”

Burundi's Tutsi leaders have long raised the spectre of genocide to justify their iron-fisted rule. Indeed, the 1994 mass murder in neighbouring Rwanda was partly a response to the tit-for-tat tribal slaughter which began Burundi's war, and claimed 250,000 lives. But Mr NkuruNziza is probably right. With the main Hutu parties inside the government, and with some Tutsi extremists negotiating with the rebels, Burundi's war is now nakedly political.

The next few weeks should show whether this makes it easier to end. The army is already putting pressure on Mr Ndayizeye to launch a new offensive against the FDD. Having little power of his own, he

will be hard-pushed to resist. Yet, to many Hutu politicians, as well as to the rebels, that would merely confirm him as a Tutsi stooge. Mindful that Burundi's three former Hutu presidents were either assassinated or forced to flee, Mr Ndayizeye's supporters could then start drifting to the rebels; redrawing the war on tribal lines.

But that need not happen. With 3,500 African Union peacekeepers due to arrive in Bujumbura, both factions are under unprecedented international pressure to make peace. The fact that Mr Buyoya was prepared to keep his promise and step aside, even as the mortars rained down, suggests this. And the fact that a member of the majority tribe is now, at least nominally, in charge, could deter the FDD's regional allies—notably, in Tanzania's government—from continuing their support.

Back in Ruyigi, several hundred fugitives are packing the town's Pentecostal church; and here there is something reassuring. Rwanda's genocide took place in many such churches, the last refuges of terrified Tutsi communities. But in this crowd are a surprising number of Hutus. “Of course, we're together, Hutus and Tutsis,” said one of them, kneeling before a candle-lit wall on which giant shadows loom.

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The “new Europe” and America

Is Poland America's donkey or could it become NATO's horse?

May 8th 2003
From The Economist print edition

Polish-American diplomacy may be deepening the divisions in Europe—or paving the way to a post-Iraq rapprochement

Get article background

WHEN Donald Rumsfeld, America's defence secretary, made his quip about “new Europe”, the concept looked more like a diplomatic crutch than a geopolitical reality. When most of the countries he had in mind signed on the dotted line in support of America's stance on Iraq, Jacques Chirac, France's president, chastised them like naughty adolescents. Now the new Europeans—at least, quite a few of them—seem to be putting their troops, as well as their land and airspace, where their mouths were. On the face of it, that might deepen Europe's divisions. Or it might help spur greater NATO involvement in Iraq and serve to heal those divisions.

The Poles are the vanguard of these Atlanticist whipper-snappers. Poland, which joined NATO in 1999 and is easily the beefiest (at least in population and area) of those set to join the EU next year, sent around 200 troops to fight in Iraq. A little improbably, it is now set to oversee one of the four sectors into which the Americans seem likely to divide the conquered country. The idea was floated last week when Jerzy Szmajdzinski, Poland's defence minister, visited Mr Rumsfeld in Washington. The Poles would like the UN to pass a new Iraqi resolution to bless the operation, but would probably go in without one—so long as America and others agree to pay.

Alexander Kwasniewski, Poland's president, will have some explaining to do when he gets together with Gerhard Schröder, Germany's chancellor, and Mr Chirac, in the Polish city of Wroclaw on May 9th, for what ought to have been a bridge-rebuilding mini-summit. It had begun to seem possible that Germany might take part in the peacekeeping effort, despite concerns that doing so might lend retrospective approval to the war itself. Peter Struck, Germany's defence minister, has been fence-mending in Washington.

But he says he found out that German troops might soon serve in Iraq, conceivably under Polish command, only when he heard it on the news; one of several tentative plans is to deploy a joint Polish-Danish-German force, now based in Szczezin, in Iraq. Germany has keenly sponsored Polish membership of both NATO and the EU, and some Germans resent the Poles' contrarian and (as they see it) hubristic behaviour over Iraq. A commentator in a leading German newspaper this week describes Poland as

America's “Trojan donkey”. Another calls the Poles “insolent”.

Several other new Europeans have flirted with America over Iraq, with a view to cosier relations. For example, Romania and Bulgaria let their bases be used as staging posts. Both are in line to join NATO; and both are keen for America to set up new permanent bases on their territory. In particular, they would like to be beneficiaries of a reorganisation of American bases in Europe, which may involve closing some in Germany and creating new ones further east, whatever Russia's moans.

There are some good strategic reasons for such a move. With the cold war over, it makes sense to concentrate American power nearer the Middle East and Central Asia, as well as the Balkans. General James Jones, the American commander in Europe, prefers lighter, expeditionary deployments to hulking installations with thousands of dependants (around 80,000 in Germany, along with the 71,000 troops still based there). Some Germans resent the Americans anyway, and Germany is expensive, though so is moving. For all that, some American congressmen see this revision of America's military posture as punishment for Germany's supposed perfidy over Iraq and a reward for its eastern neighbours' loyalty.

Watch it, you oldies

All this looks bad for some “old” Europeans. Every offer of support from newcomers (as well as from oldies such as Spaniards, Italians and Danes) for Iraq's reconstruction helps make the American-led campaign seem more than just a quixotic Anglo-Saxon crusade and serves to isolate the rejectionists, some of whom are concluding that the Americans are trying to divide and rule (or at least marginalise) the Europeans. An American pull-out from Germany would be a huge political snub to an old ally, and cost thousands of jobs.

In fact, a lot of the Americans are likely to stay put (at Ramstein air base, for instance). And Poland's adventure in Iraq could, in the end, help heal the divisions within Europe, and between Europe and America, rather than exacerbate them.

Germany, far more than France, is currently trying to scramble off the hook on which its pre-war diplomacy over Iraq landed it. And America, while pleased that the Poles and others are offering to lend a hand in Iraq, would prefer to have a more substantial, multilateral imprimatur for their endeavours. Ideally, if the terms suited, it would come from the UN.

But there are other possibilities. Poland and the other new Europeans could help both sides out by drawing other NATO countries in. It is understandable, given their country's history, that the Poles are enjoying punching above their weight and being fêted by President George Bush (who may visit them soon) and Mr Rumsfeld. At the same time, they are already stressing that they want European countries to share the burden. The 1,500-2,200 Polish soldiers that are being talked about for Iraq are hardly enough for the job.

In due course that may mean a NATO involvement in Iraq. If the Poles were to request NATO's help, some fellow members might be more accommodating than they would be to a direct American request. The Poles, who care about NATO and America's commitment to it more than some other members, would like to prove to the Americans that NATO still has its uses, despite recent form. Something similar has happened in Afghanistan, where NATO has eventually assumed a big role. So Poland may yet turn out to be NATO's Trojan horse rather than America's donkey.

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Russia's Muslims

Facing extreme prejudice

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Russia's Muslim population is growing and changing, but the government's approach to it is not keeping pace

AP

Tadzhuddin nearly lost his headgear

WHEN Talgat Tadzhuddin declared *jihad* on the United States a month ago, he probably thought Vladimir Putin would be pleased. Russia's president had condemned the war on Iraq. The chairman of the Muslim Spiritual Board, based in the city of Ufa, in Bashkortostan, wanted to show support. It is even thought that someone in the Kremlin gave him the go-ahead. But the venture backfired. Mr Putin disapproved, Mr Tadzhuddin was threatened with prosecution, and Ravil Gainutdin, the Moscow-based head of the Council of Muftis and Mr Tadzhuddin's arch-rival, moved one step closer to the position they both covet, that of Islam's chief spokesman in Russia.

Yet both men have reason to be wary. Mr Putin has shown that he likes to deal with religions, as with other social organisations, along Soviet lines: through a single, pliable leader. The patriarch of the Orthodox Church has long been a key lever of governmental influence. Mr Putin's administration has heavily favoured one of the two chief rabbis who vie for leadership of the Jewish community. “I think the president would find it comfortable to have one person who represented Islam at a high level,” says Mr Gainutdin, with thinly veiled ambition.

Such a leader would, in theory, speak for an increasingly important part of Russia. Muslims number anywhere from 11m to 25m, or 7% to 17% of the population, including those who are culturally Muslim but do not practise the religion; nobody will know the figures for sure until data from last year's census are published. But they are likely to show that Russia has a higher proportion of Muslims than any western European country. And, unlike the rest of Russia's population, the Muslim community is almost certainly growing. Moreover, since the Soviet Union collapsed, giving freedom to study in religious schools and make the *haj*, there has been an enormous Islamic revival; over a thousand new mosques and dozens of religious schools have opened, often with government assistance.

It is no surprise, then, that the Kremlin wants control through a single leader. Especially since the Russian state is at least as twitchy about Islamic extremism as the American one. Russia has a huge border with mostly Muslim Central Asia; the Middle East is not far away; and in the breakaway republic of Chechnya there is a strong current of Islamic radicalism among the rebels. Officials regularly blame “Wahhabis” for stoking the conflict.

Yet their fear seems to be based on ignorance. “The main directorate of the FSB [the internal security service] anti-terrorist unit has no real Islamic expert,” says Shamil Beno, a former Chechen foreign minister. Wahhabism is a purist form of Islam founded in the 18th century and now prevalent in Saudi Arabia, but the Soviet authorities first used the term to label all enemies in the Afghanistan war in the 1980s, and it was later applied to radicals in Chechnya and other parts of the North Caucasus, whatever their religious sect.

Wahhabism and extremism do exist there; but both are imports. Unlike their brethren in western Europe, most of them immigrants, Russia's Muslims predate its Orthodox Christians. And while those of the Caucasus have always been more rebellious than the communities concentrated in the Volga-Urals area (see map), many of their leaders too collaborated with the Soviet authorities. Radicalism has only

appeared in the Caucasus in the past five years, according to surveys by Galina Yemelianova, at Birmingham University in England, and her colleagues. The desperation after years of war and poverty, she says, made some people receptive to the preaching of missionaries from the Middle East and itinerant mujahideen from Afghanistan. In other areas, she says, it is a tiny phenomenon.

Yet Wahhabism has become such a buzzword that both the rival muftis, in their attempts to win favour with the Kremlin, have accused each other and other Muslim leaders of fomenting it. Chechnya's Moscow-appointed administrator and former mufti, Akhmad Kadyrov, was once a separatist rebel but got his current job partly because he condemned Wahhabism as alien to the region's Sufi traditions. And the fear of extremism makes a handy smokescreen for the government's failure to deal with the causes of the Chechen conflict. “It's more comfortable for a guy like Putin to think of a strong threat and put aside social and economic problems with local roots,” says Alexei Malashenko, of the Carnegie Endowment's office in Moscow.

The result is that Russian non-Muslims increasingly fear Islam, while Russian Muslims increasingly distrust the authorities. One sign of the gulf between them came last year when the interior ministry banned women from wearing headscarves in photographs for official documents. A group of women in Tatarstan, where headscarves had fast become popular, challenged the ban as an unconstitutional curb on freedom of religion. This March the Supreme Court turned down their final appeal. As Islamic movements gain strength, other sore points, such as the army's refusal to allow Muslim services on base, could breed open conflict too.

Which is why the government badly needs a good go-between; and why Messrs Gainutdin and Tadzhuddin are slugging it out for the job. The problem is that neither they nor anyone else can claim to speak for Russia's Muslims. Clerics' positions “are more related to their closeness to power than to their spiritual authority,” says Dmitry Makarov, of Moscow's Institute for Oriental Studies. No one imam has widespread appeal. Heidar Jemal, chairman of the Islamic Committee and the most prominent non-clerical Muslim spokesman, agrees: “These are bogus muftis...The real Muslim leaders are many: political leaders, moral and ideological figures, businessmen.”

They are, in fact, such people as Mr Jemal, who sprinkles his conversation liberally with references to Hegel and Kant and wants to rejuvenate Islamic philosophy. Or Mr Beno, who hopes to set up a new school of *fiqh* (Islamic jurisprudence). Muslims in Russia, like those across the world, face growing questions about their faith, he says, and therefore “the deepening of fundamentalism in Russia is inevitable...But this is a purely religious process; it isn't extremism.” The question is whether the Kremlin can understand that. Unfortunately, its current approach tends to treat new movements as potential threats—and that risks turning them into real ones.

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Austria's big strike

Meet Wolfgang Thatcher

May 8th 2003 | VIENNA
From The Economist print edition

Austria's old system of consensus and compromise may be under threat

AP

Salzburgers saying no to Schüssel

THE annual average number of days lost per Austrian worker as a result of strikes used to be measured, not actually in days, but in seconds. That was thanks to the country's vaunted “social partnership”, a corporatist arrangement set up after the second world war whereby trade union officials, business leaders and government ministers cut back-room deals on wages, work conditions and most social and economic legislation. For half a century, it worked. This week, on May 6th, the country was brought to a halt by a rare country-wide strike. Is the old system falling apart?

The strike, organised by the main trade-union group, the ÖGB, stymied public transport and closed schools and dozens of the country's biggest companies, in protest against the government's plans to overhaul Austria's pension system. The unions say they will continue various strikes until the coalition of Chancellor Wolfgang Schüssel's People's Party and the far-right Freedom Party withdraws its controversial proposals.

Mr Schüssel is unlikely to budge—and the union leaders probably know it. Most Austrians feel edgy about the government's pension proposals, which would reduce pensions under the current pay-as-you-go system for future retirees by a good 10% (and by 30% in some cases). Most of them support the strikes. But they would probably change their minds if the unions' activities were to start disrupting ordinary people's lives on a wider scale and if the economy began to suffer badly as a result. Austrians certainly don't tolerate strikes in the way many Italians and French people do. So Mr Schüssel will sit tight. Unless the Freedom Party's former leader, Jörg Haider, a maverick populist, launches another revolt within his party, parliament will probably pass the pension bill next month.

The union leaders see strikes as the only way to reassure their angry members that the unions still care—and matter. But they could risk playing into Mr Schüssel's hands. For he is determined to end Austria's system of consensus politics, which he thinks is preventing the country from meeting the challenges of globalisation and from succeeding in an ever-more-competitive world market.

His first blow against the old culture of compromise came three-and-a-half years ago when he took his party out of the “grand coalition” led by the Social Democrats and struck a controversial bargain with Mr Haider's Freedomites. A new coalition of the unadulterated right pushed Austria's traditional social partners—the trade-union association, the left-wing chamber of labour and the conservative business chamber—to the sidelines, while letting them draft some bills, including one that obliged companies to set up private pension schemes.

But in this latest spat, over state pensions, Mr Schüssel has decided to snub not only the trade unions but also the business chamber and its president, who leads a powerful faction in Mr Schüssel's own party. The chancellor, it seems, looks to Margaret Thatcher for his inspiration. If he can cut the unions down to size, he intends to liberalise further, among other things by loosening Austria's restrictive shopping hours and by weakening labour-market protection.

If that means a prolonged punch-up with the still powerful unions, some businessmen fear that investors may be scared off. Until now, social partnership and the pragmatism of unions and bosses have helped make Austria rich. Much depends on whether Mr Schüssel's more abrasive approach continues to be backed in his own party, most of whose members probably still prefer the old system of *Gemütlichkeit* (cosy joviality) to the bone-cracking of a Thatcherite revolution.

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Croatia's politics

A voice fromthe grave

May 8th 2003 | ZAGREB
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A dead general shows up the feebleness of a shaky government

EPA

WHEN Janko Bobetko (pictured right) died on April 29th, the government of Croatia probably breathed a sigh of relief. But that was before the funeral of the 84-year-old general on May 2nd provided yet more evidence of the confusion within Ivica Racan's centre-left government.

Bobetko, a former Yugoslav army general, had been wanted since last September by the UN's war-crimes tribunal in The Hague for atrocities allegedly committed by his troops when he was chief of staff of Croatia's army during most of the war of independence in the early 1990s. Fearful of reaction from a public used to seeing him as a hero, the government challenged the indictment in The Hague, and then, when that failed, declined to hand the indictment to Croatian judges for processing.

In the end, the government's blushes were spared when doctors ruled that the ageing general was too ill to stand trial. But already the previously friendly British and Dutch governments had frozen action on the European Union's “stabilisation and association” agreement with Croatia, an early step towards future EU membership.

The doctors' ruling still left an embarrassment: what was to be done next with the general? His death solved that problem—but not for long. The government was unable to persuade his family to accept a state military funeral. The funeral instead became a rally for the nationalist right. Mr Racan had to put up with severe criticism when he paid his respects at the cemetery after the service.

The muddle has been typical of his government since it took power in early 2000 after defeating the nationalist Croatian Democratic Union (HDZ) in a general election. The government has quivered at the prospect of protests by war veterans over extraditions to The Hague, and by trade-unionists over economic reforms. With a general election due early next year but likely to be held this year, it has grown even more timid, in a variety of areas.

It has offered to guarantee the debts of several troubled companies—a tactic expensively and unsuccessfully used by the HDZ government as the previous election approached. Privatisation remains stalled; a row with the Peasants' Party, the largest coalition partner of Mr Racan's Social Democrats, led him to dismiss the entire board of the privatisation agency. Even the government's application in February for full EU membership seemed an act of gesture politics rather than policy.

It is all a far cry from the excitement of January 2000, when the then opposition swept aside the HDZ after nearly ten years of the late President Franjo Tudjman's nationalist, authoritarian rule. A disillusioned electorate is even looking again towards the HDZ. In the end, distrust of that party, and fear of what the EU might say, may prevent the nationalists recapturing power. If so, Mr Racan will owe his survival to this, not to his own efforts.

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German universities

Pay up, young'uns

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The taboo against making students pay fees at state universities is being broken

FOR three decades, all state higher education in Germany has been free. Just before last year's general election, Chancellor Gerhard Schröder decided to enshrine this in law, at least for first degrees. But now, with an ever-tighter squeeze on public spending, a growing number of university heads and governments of Germany's 16 *Länder* (states) are arguing for student fees, to ease universities' crowded lecture halls, update their ill-equipped libraries and improve their declining research performance.

Although Germany's universities are free, less than a third of school-leavers go on to them, compared with an average of nearly half in other rich countries. And nearly a third of those who do go drop out before completing their course—double the British rate; under a fifth actually get a degree. The *Diplom*, as a first degree is called, is of a higher standard than the American or British equivalent. But Germans take, on average, six-and-a half years to get it. Many take far longer, all at the taxpayers' expense.

As a spur to dawdlers, the Christian Democratic state of Baden-Württemberg decided four years ago to introduce fees of *euro*500 ($550) for every half-year of study after six-and-a-half years. The scheme has halved the number of long-term students, while putting extra cash into university coffers. Three other states run by Christian Democrats—the Saarland, Hamburg, and Thuringia—plan to follow suit.

Some Social Democrats are also beginning to broach what has long been considered a taboo subject among their faithful. Wolfgang Clement, the government's superminister for economics and employment, was himself not so long ago keen on the idea. In the general-election campaign last summer, he said that long-term students in North Rhine-Westphalia, Germany's most populous state, of which he was then premier, would have to start paying fees. Thousands promptly took to the streets in protest. Fearful of losing votes, Mr Schröder hastily called Mr Clement to order. A university place, he declared, should depend on “what a student has in his head, not what daddy has in his wallet”. Federal legislation banning fees for first degrees was hastily rushed through.

The idea of fees for long-term students was not, in fact, squashed flat, as the ban covers only the four or five years deemed normal for a first degree. Baden-Württemberg and five other Christian Democratic states have nevertheless decided to challenge the ban before the Constitutional Court, arguing that the federal government has no right to intervene in education, which is meant to be a strictly state responsibility.

Their challenge could well succeed. Fees could then soon become common, especially if Mr Schröder fulfils another election pledge, to raise the proportion of school-leavers going to university from 30% to the OECD's average of 45%. Many universities feeling the pinch (in Berlin, for instance) would be pleased.

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Charlemagne

Snoring while a superstate emerges?

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The European Union's powers are quietly but steadily growing

Get article background

CRITICS of the European Union often warn that it is in danger of mutating into a “superstate” which gobbles up the powers of the 15 countries that belong to it. Rather than being alarmist, this warning is in some ways curiously behind the times. In most EU countries more than half of new laws are already drafted in Brussels and then simply translated into national law.

Getting firm statistics is tricky. *The Economist* contacted all the major Brussels institutions and embassies to ask for estimates of the balance between national and European legislation across the EU. In most cases the responses were variants of “darned if I know”. But of those prepared to offer a number, all reckoned that EU legislation now accounts for more than 50% of new laws. The Austrians think that 60-70% of their domestic legislation is now framed in Brussels. A study by France's Conseil d'Etat in the early 1990s estimated that 55% of new French laws were being drafted in Brussels, a figure thought to have remained broadly stable. Lord Inglewood, a British member of the European Parliament's constitutional affairs committee, puts the figure for Britain at about 50%. John Cridland of the Confederation of British Industry reckons that, of the 120 policy dossiers his organisation is dealing with, around half are essentially European issues—ranging from health and safety regulations, to the rules about temporary work and the standardisation of railway gauges.

The single biggest torrent of European legislation was unleashed by the formation of a single market which was agreed upon in 1985. As the single market has bedded down, the number of new directives and regulations decided on in Brussels has actually declined—from over 361 in 1995 to a mere 241 in 2000. But this may be just a temporary pause. This week the European Commission announced plans for a new lot of legislation to bolster the single market for services, which account for 70% of GDP. The commission is hoping to push through legislation tackling everything from the regulation of professional qualifications to sales promotions.

The EU's writ runs well beyond internal-market regulations. The biggest areas for new legislation at the moment are the environment, public health, consumer protection and internal security. For all the talk of “subsidiarity”—making law and policy at the most local level possible—the urge to Europeanise is still very powerful in Brussels. Both the commission and the European Parliament have an institutional interest in expanding their powers (“competences”, in Euro-speak). The system of giving each country six months to set the EU's policy agenda also encourages headline-grabbing initiatives. Nick Clegg, a Liberal Democratic MEP, argues that, though the flow of new laws has slowed,“The political momentum towards a relentless expansion of the *acquis* [EU law and competences] is constant.”

Sometimes it takes a crisis to create an opening for action from Brussels. The terrorist attacks on the United States generated the political will to push through an old idea—to create a European arrest warrant—which had hitherto been too controversial, since it expands the EU's remit into criminal law. Last year's oil-spill off the coast of Spain led to a new drive for European legislation on tankers. Rulings from the European Court of Justice also play a role in expanding EU powers. Last November the court ruled that bilateral airline deals struck between individual EU countries and the United States violate European law, so the commission is now pressing to take over the negotiation of international aviation deals.

The rule of thumb is that an EU role is demanded wherever a faintly plausible case can be made that an issue needs to be dealt with “on a cross-border basis”. But even this rule can be ditched, particularly if a piece of legislation can be sold as socially progressive. The working hours of professionals like doctors in

one EU country have few implications for the citizens of another, but they are regulated in Brussels in the name of “the European social model”. On occasion this desire to promote an EU vision of society leads to a higher level of policy integration than is achieved in the United States. For example, the death penalty is banned across the EU but in America it is for individual states to decide whether to keep it or not.

There were those who hoped that the convention on Europe's future, currently under way in Brussels, would lead to a little judicious trimming of the EU's powers. That now seems highly unlikely. Alain Lamassoure, a prominent member of the convention, reckons that the EU's powers will stay broadly stable, with one big exception—immigration and internal security—where they will be expanded. He argues that the convention's real goal should be to ensure that the Union's enormous powers are exercised in a more open and democratic fashion.

Wake up!

That is surely desirable. But it still seems unlikely that the European public will take much interest in the goings-on in Brussels. This somnolent attitude is an irritation both to Euro-enthusiasts and to Euro-sceptics, who find it baffling that people take so little interest in the making of the laws that govern their lives.

But there are explanations. The EU may account for more than half of all legislation across the Union, but it tends to deal with the boring stuff. The issues that get people marching in the street—pensions, welfare benefits, education—are still largely run at a national level, although the EU is beginning to nibble at the edges. New directives are in the works to regulate cross-border aspects of pensions and health care. And while the European Union is a legal and regulatory giant, it is a fiscal dwarf. The total EU budget is around 1% of its members' total GDP, compared to a federal budget in the United States of around 24% of GDP. The Union has also yet to win the right to levy taxes. Europe's nation-states have handed over the legislator's quill-pen to Brussels, but they are still—so far—keeping a fairly firm grip on their wallets.

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Betting

Flutter away

May 8th 2003
From The Economist print edition

Magnum

Home of the high-class race-meeting, Britain is now leading a different bit of the business: online betting

WHO will win the race to dominate the global betting industry, and take billions in prizes? On current form, the hot favourite is Britain, thanks to a mixture of history, enterprise and legislation. Global gambling is on the rise chiefly because of technology, which makes it possible to place bets cheaply over long distances. That allows people in countries where betting and gambling are either corrupt (as in many east Asian countries) or crippled by legislation (as in America) to move their business to friendlier environments.

Britain's first big advantage is a good reputation abroad. Place a bet in a betting shop, and you have someone solid to complain to if something goes wrong. Farther away, you need more reassurance. Britain's big and respectable betting businesses score heavily over outfits on wilder shores like the Caribbean.

By abolishing betting tax in October 2001, the government has brought almost all British-owned off-shore betting businesses back to this country: turnover has risen from £8 billion ($13 billion) to £15 billion, of which a big chunk—up to a third on big events—is already wagered from abroad. If gambling becomes as mobile as other forms of betting—financial markets, for example—the global business could eventually be much bigger than the domestic one. Britain already has around three-quarters of the cross-border betting market. The government estimates, perhaps conservatively, that cross-border gambling will grow to £10 billion by 2005.

This suits another British strength: betting exchanges, which match gamblers wanting to bet for or against a particular outcome. These do for opinions what websites such as eBay do for goods: shrinking margins and clearing markets. The winner pays the exchange a commission of between 2% and 5%.

The crucial advantage is that, unlike traditional fixed-odds bookmakers, the people managing exchanges need know nothing about the subjects of their customers' bets—say, Italian cycling or sumo wrestling. Bets can be for or against anything legal with a clear outcome.

With slimmer margins (much less than the 14% raked off by traditional bookmakers) exchanges also

offer punters a much better deal. In an industry renowned for taking cash from the poor and gullible and giving it to the rich types who take the bets, exchanges are shifting the odds in the punters' favour. Growth has been rapid. Britain's biggest exchange, Betfair, founded in 2000, turned over £1.5 billion last year, handling up to 20,000 bets a minute, with, it says, business growing by 15% a month.

The main handicap for Betfair and its smaller rivals has been the combination of out-of-date laws and angry competitors. The big conventional bookmakers—outfits such as William Hill, Ladbrokes and Coral—argue that anyone matching a bet on an exchange is in effect a bookmaker, and thus needs a licence. Last week the government issued a consultation paper that ruled this out.

All that is excellent news for those with global ambitions “Britain is the natural world centre of gambling,” says Leighton Vaughan Williams, an economist who heads the Betting Research Unit at Nottingham Trent University. “There is nowhere else that has the size, the tradition, the marketing and the probity.”

The big question now is what to do about customers in countries, chiefly America, where cross-border gambling is illegal. The government's consultation paper says that decisions on how far to abide by other countries' laws should be left to individual businesses, who will decide whether they want to take the risk of legal action and other sanctions. Betfair declines to take American credit cards. However, such measures are little obstacle to the determined or ingenious punter. In the long run, it will be increasingly hard for countries to protect either puritan ethics or their own gambling industries.

Britain's established bookmakers may now have to rethink their opposition to the exchanges' business model. The Totalisator, or Tote for short, a well-run state-owned bookmaker, is changing its ownership structure, which will allow it to compete more aggressively. It might team up with Betfair to establish a really powerful international brand. If Britain's big bookies can swallow their pride, they can follow suit, either individually, or perhaps with a jointly run exchange. No strangers to risk, the biggest bet they are now making is on their own future.

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BBC digital

Ethereal programmes

May 8th 2003
From The Economist print edition

What's the point of BBC3? Not a lot. But BBC bosses plough on

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THE most striking feature of the latest television viewing figures was not that more people now watch multichannel television rather than any single broadcast channel. The drift away from the broadcast networks has been taking place steadily for years. Rather, it was that not one of the top ten TV multichannel shows was on a BBC digital channel. The newest of these, BBC3, a youth channel launched amid great fanfare in February, is now luring on average only a few tens of thousands of viewers—not much more than BBC4, its little-watched year-old high-brow sister channel.

The two channels may share a failure to draw viewers. They offer contrasting lessons, however, in the purpose of public-service broadcasting.

The government always had doubts about the point of BBC3. It delayed giving it approval, and then imposed tight rules on what sort of programmes it had to air. At its launch, Stuart Murphy, its controller, promised a channel “packed full of modern, radical, imaginative and funny British shows”. Compared with its commercial rivals, such as E4 or Sky One, whose schedules are filled with American imports, the channel's programmes about architecture or ex-convicts certainly feel different.

Yet, sure enough, BBC3 is failing to pick up viewers for such shows. It lured a fair number when it aired advanced episodes of “EastEnders”, BBC1's mass soap, in its first weeks. Since then, however, its viewing share has tailed off to well below that of Sky One and E4. Its most talked-about show is, naturally enough, its least worthy: Celebdaq, a celebrity stock-trading game show tied in to a game on the BBC's website, in which viewers' stocks rise or fall in relation to the number of column inches a celebrity gets in the press.

At last, a success that BBC3 could build on? Not if it is to obey the government's edict that the channel has to be “genuinely distinctive”. It is hard to find a better definition of commercial programming than celebrity-driven reality-TV. Which puts BBC3 in a bind. If it makes popular “youth” shows, it is berated for doing what the market already does. If it makes unpopular worthy ones, it is criticised for failing to draw audiences.

But why is BBC3's failure to get anybody to watch any more damning than that of BBC4, whose recent output includes such ratings-grabbers as a six-part series on the world economy, and whose audiences are seldom bigger than those of the History Channel? Because BBC4 was aimed at a genuinely narrow niche; it entered a market served by almost nobody else; and it serves it cheaply. BBC4 is a model of public-service broadcasting in the sense that it makes programmes that the market does not.

BBC3, on the other hand, is designed not for a niche but a massively wide demographic group: 18-34-year-olds. This market was already served by a multitude of others, from E4 to MTV, Paramount Comedy, Kiss TV, Kerrang, Smash Hits and so forth. And BBC3 is doing all this with nearly three times the budget—£97m a year—of BBC4.

The BBC has not given up on BBC3. Far from it: it is heavily promoting its shows with free advertising on the mainstream BBC channels—much more so than it is for BBC4. Which is one reason that some insiders feel that the corporation is leaving BBC4 to languish in its cultural ghetto at the very moment when the channel is supplying the corporation with its best public-service justification. The corporation may not be giving BBC4 much backing. But it usefulness has not escaped Greg Dyke, BBC director-general. He recently appointed Roly Keating, BBC4's controller, to head the BBC's effort to renew its charter, which

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Anti-Semitism

Tam o'slander

May 8th 2003
From The Economist print edition

British leftwingers' selective prejudice

Get article background

Fuzzy, nasty and wrong

IN America, Tam Dalyell would now be leaving public life in disgrace. That, after all, was the fate of Trent Lott, the Senate majority leader, after an oblique and nostalgic reference to the days of segregation. But Mr Dalyell's claim that a Jewish cabal around the prime minister was distorting Britain's policy to Israel has caused only a few ripples. Unlike George Galloway, another anti-Israeli Labour MP suspended from the party this week for his devotion to Saddam Hussein, Mr Dalyell—the party's most senior backbencher and a famously idiosyncratic politician—has provoked nothing more than tolerant sighs.

Anti-Semitism in Britain has traditionally come from two corners: loutish outfits on the extreme right, who do things like leaving pigs' heads outside synagogues, and snobbish prejudice in some corners of the upper classes. Both seem to be on the decline. But Mr Dalyell's remark brings out a newer streak, of left-wing bigotry. Barry Kosmin, editor of a forthcoming study of British anti-Semitism, says Mr Dalyell combines “aristocratic prejudice” about the “cancerous nature of Jews in society” with the left-wing anti-Zionism that sees Israel as racist and colonialist. This combination, he says, is familiar in France but new in Britain.

Oddly, the leftwingers in politics and the media who most readily drift into crass anti-Semitism, particularly by conflating British Jews with Israeli misdeeds, real or imagined, are also those who react with horror to even the faintest stereotyping of groups like blacks, gays or Muslims.

But the oddest thing of all was that Mr Dalyell's remark was so inaccurate. Two of the three men he mentioned, Peter Mandelson and Jack Straw, are not, by their own description, actually Jewish. Their partially Jewish ancestry would make them so only under Nazi-style race laws.

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Local elections

A plague on all your houses

May 8th 2003
From The Economist print edition

How England's votes changed
% change in local-election vote since:

	1999	2002
Conservatives	1.4	0.2
Labour	-4.6	-2.8
Liberal Democrats	2.3	2.5
BNP*	*	5.9
Greens	2.8	1.5

*The BNP fought too few seats in 1999 to provide a reliable measure

Source: John Curtice and Steve Fisher

The Tories can take little comfort from the local-election results

AS THEY usually do at local-election time, Britain's three main political parties have been squabbling about which did best. Actually, none did well in the elections to the Scottish Parliament, the Welsh Assembly and almost every English district council outside London. May 1st was a night for the fringe.

In England the far right British National Party increased its support. It won almost a fifth of the vote in those wards it contested in a sample of 60 English local authorities analysed for *The Economist* by John Curtice of Strathclyde University and Steve Fisher of Oxford University. Its vote increased on last year by, on average, almost six percentage points. Its best performance was once again in Burnley, a poor northern town with a big Asian population, where it won seven seats as well as the largest share of the vote.

The BNP is still a small organisation, fighting little more than 200 of the more than 10,000 seats contested last week. But the party's success is not confined to poor working-class wards. Nor can it simply be blamed on low turnouts—if anything, the BNP mobilises voters who would otherwise stay at home. In short it is proving highly adept at exploiting widespread concerns about immigration aroused by the debate about asylum-seekers.

In Scotland, meanwhile, the far left prospered (see box). Thanks to the parliament's proportional electoral system, the nearly 7% of the second vote obtained by both the Greens and the Scottish Socialist Party secured them seven and six seats respectively.

The Greens advanced in England, too, winning on average 8% of the vote where they stood. Independents flourished, overturning Labour's control in Mansfield, while three independents were elected to the Scottish Parliament and one to the Welsh Assembly. All in all, around one in eight of those who voted in Britain last week opted out of the mainstream.

The main opposition party, not the fringe, is supposed to profit from voter disaffection. Yet the Conservatives' vote rose only a little—up four points in Wales, and only one or two in both England and Scotland. Even so, the pressure on Iain Duncan Smith to resign as leader eased as the party made over 500 net gains of council seats.

The Tories were lucky. While their vote advanced only a little, Labour's fell by nearly five points. That alone meant at least 200 gains. But at the same time the pendulum swung more strongly away from Labour in the smaller of England's unevenly sized wards, and in those wards the party was defending (often in fact to the Liberal Democrats). That enabled the Tories to win a lot more seats than they would

have otherwise. General elections, however, are rarely won by luck.

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Scottish and Welsh nationalism

Rats to the nats

May 8th 2003 | EDINBURGH
From The Economist print edition

If devolution was a cunning plan to kill nationalism, it seems to be working

Get article background

SETTING up the Scottish Parliament, the doom-mongers warned, was building a political motorway with only one exit—Scottish independence and the end of the British state. But as the new parliamentarians took their seats on May 7th, after the first elections since devolution four years ago, the Scottish National Party (SNP) was down from 35 members to 27. Plaid Cymru, the Welsh Nationalists, were down from 17 to 12.

Both parties now have two big problems. The first is that, before devolution, they got lots of protest votes. The SNP complained about everything from nuclear weapons to the treatment of the fishing industry. Plaid, whose roots lie in defending the Welsh language, was less protest-orientated, but in 1999 it still picked up Labour voters upset by Tony Blair's interference in Welsh politics.

This time around, both were trying to be seen as grown-up parties of government, and focused on serious issues, such as improving public services. But both failed to convince voters that they were plausible governments. Scottish protesters had more convincing alternatives, such as the Trotskyite Scottish Socialist Party (which won six seats) led by the charismatic Tommy Sheridan, and the Greens, who picked up seven seats. In Wales, the election of the popular Rhodri Morgan as first minister in 2000 shot Plaid's fox.

Celtic crumble

Scottish Assembly* election results

	% of vote	% change since 1999
Labour	29.3	-4.3
SNP	20.9	-6.4
Conservatives	15.5	0.1
Liberal Democrats	11.8	-0.6
Greens	6.9	3.3
SSP	6.7	5.7
Others	8.9	3.2
Turnout, %	49.4	-8.8

Welsh Assembly* election results

	% of vote	% change since 1999
Labour	36.6	1.2
Plaid Cymru	19.7	-10.8
Conservative	19.2	2.7
Liberal Democrats	12.7	0.2
Others	11.9	6.7
Turnout, %	38.2	-8.2

Source: John Curtice and Steve Fisher *Second vote

Their second problem is how to sell the idea of full independence when voters are unimpressed by what their new parliaments have done with the limited powers devolution granted them. The SNP tried to set this aside by promising that it would hold a separate referendum on the issue. Plaid has shelved the question, to deal with it at a later date, perhaps at a constitutional convention.

But campaigning for independence was what distinguished the nationalists—especially the SNP—from the rest. That leaves John Swinney, the SNP leader, with a problem. He now faces a party divided between those who want to go back to old-time tub-thumping, and those who think a gradual accumulation of power by the parliament is a better, though longer, route. Either way, both parties look to be stuck on the hard shoulder of politics for some time.

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Bagehot

Consuming passions

May 8th 2003
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The Labour Party is as confused as it is divided

IT HAS taken a while for Britain's political classes to recover from their post-war torpor, but the row over giving a few hospitals a bit of autonomy in the way they manage their affairs has done the trick. The government's modest plans for introducing so-called “foundation” hospitals to England's highly centralised health-care system have had backbench and union critics up in arms, accusing it of destroying the founding principles of the National Health Service. So profound was the government's unease about the scope for a damaging rebellion that before a vote that they easily won ministers seemed more intent on saying what foundation hospitals were not than what they are.

Yet the idea that Tony Blair and Alan Milburn, the health secretary, are conspiring to end the system whereby health care is free at the point of use and treatment is based on clinical need rather than the ability to pay is manifest poppycock. So what is really going on? At the heart of the arguments over public-service reform now raging within the Labour Party are two quite distinct and opposing ideas of citizenship, not to mention a good deal of intellectual confusion.

As Catherine Needham argues in a pamphlet published last month by Catalyst, a leftish think-tank, the real split is not over foundation hospitals as such, but over the nature of the relationship between the citizen and the providers of public services. On one side is a traditional, sentimental Labour view that good public services not only express the value the community places on collective provision, but define the nature of the community itself. Implicit in this is the belief that citizenship stems from the social solidarity that is fostered by shared interests and decent minimum standards.

On the other side are those New Labour types (including Mr Blair) who are edging towards neo-liberalism. They see citizens as consumers whose relationship with the state is largely bilateral and whose political preferences are revealed mostly by economic decisions. Although they recognise that there are difficulties, they want public services to be provided more like privately supplied goods. That way, they believe, people will gain more control over their lives.

It is an article of faith for Mr Blair and New Labour that the party helped to make itself unelectable because its response to Thatcherism was a knee-jerk defence of public-sector unions combined with unthinking hostility to the privatisation of the old state monopolies. Just as Labour had allowed itself to become associated with the drabness of rationing in the 1950s, in the 1980s it looked equally out of touch in identifying itself with producer interests instead of coming to terms with the rampant consumerism the Tories had unleashed.

In a speech to the Labour Party conference in October 2001, dripping with frustration over what he regards as the almost pre-historic attitudes of many in his party, Mr Blair said: “This is a consumer age. People don't take what they're given. They demand more.” Mr Milburn, defending his proposed NHS reforms, echoed: “We are in a consumer age whether people like it or not. What will destroy the public services is the idea that you can retain the ethos of the 1940s in the 21st century.” In particular, Mr Blair reckons that the prosperous middle classes, whose taxes pay for hospitals and schools, will desert the public sector unless service providers start to respond to their needs as the private sector does.

Mr Blair and Mr Milburn are right: the time when people were grateful for whatever they were given has gone. And the last few years of rapidly rising spending on health unmatched by better results should have silenced opponents of change. But even now, the prime minister appears uncomfortable about where the logic of his argument is taking him.

Mr Blair yearns for a “third way” that reconciles what Ms Needham disapprovingly describes as the “self-

regarding", atomised citizen-consumer with the good old Labour values that his critics claim he doesn't understand and is doing his best to undermine. He continues to insist that the reason he believes so "passionately" in public services is "because they are what community is all about. They bind us together."

Any colour as long as it's black

Mr Blair might not go as far as the Catalyst paper, which advocates a form of "civic republicanism" that would judge public services on the basis of what they contribute to society rather than whether consumers were satisfied. But one aspect of the blueprint for the new foundation hospitals suggests that Mr Blair is in a muddle.

In a bow to the currently fashionable "new localism", the foundation hospitals will supposedly be answerable to boards of governors of which a majority will be elected from the local community and patients. Not surprisingly, the detail of how this might work is distinctly lacking. However, given the complexity of modern hospitals and the tensions that are bound to arise between local worthies, who are likely to be natural conservatives, and managers to whom the government has given the freedom to expand and innovate, there is plenty of scope for trouble in the future.

What New Labour's citizen-consumers lack is not democracy or community but market power. By constantly talking up choice and diversity, the government has raised expectations in a way that its cautiously incremental approach to reform can't hope to satisfy. Until there is real competition between providers and some surplus capacity within the system, for most people wanting to educate a child or book an operation, choice will be as academic as it was for Henry Ford's first customers. The one way in which citizens are likely increasingly to resemble real consumers is in their willingness to complain.

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Paradise lost

May 8th 2003
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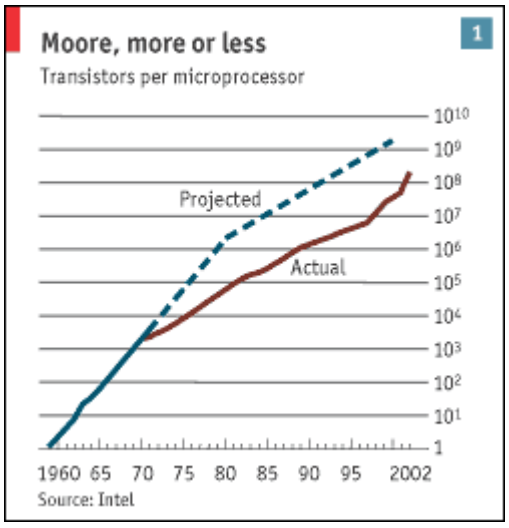
So far, information technology has thrived on exponentials. Now it has to get back to earth, says Ludwig Siegele

CLOSE your eyes and think of information technology. You might picture your PC crashing yet again, and recall that your teenager was supposed to fix it. That leads you to the 12-year-old hacker who broke into a bank's computer system the other day, which brings to mind the whizz-kids in a garage inventing the next big thing that will turn them into the youngest billionaires ever.

In IT, youth seems to spring eternal. But think again: the real star of the high-tech industry is in fact a grey-haired septuagenarian. Back in 1965, Gordon Moore, co-founder of Intel, the world's biggest chipmaker, came up with probably the most famous prediction in IT: that the number of transistors which could be put on a single computer chip would double every 18 months. (What Mr Moore actually predicted was that the figure would double every year, later correcting his forecast to every two years, the average of which has come to be stated as his “law”.)

This forecast, which implies a similar increase in processing power and reduction in price, has proved broadly accurate: between 1971 and 2001, transistor density has doubled every 1.96 years (see chart 1). Yet this pace of development is not dictated by any law of physics. Instead, it has turned out to be the industry's natural rhythm, and has become a self-fulfilling prophecy of sorts. IT firms and their customers wanted the prediction to come true and were willing to put up the money to make it happen.



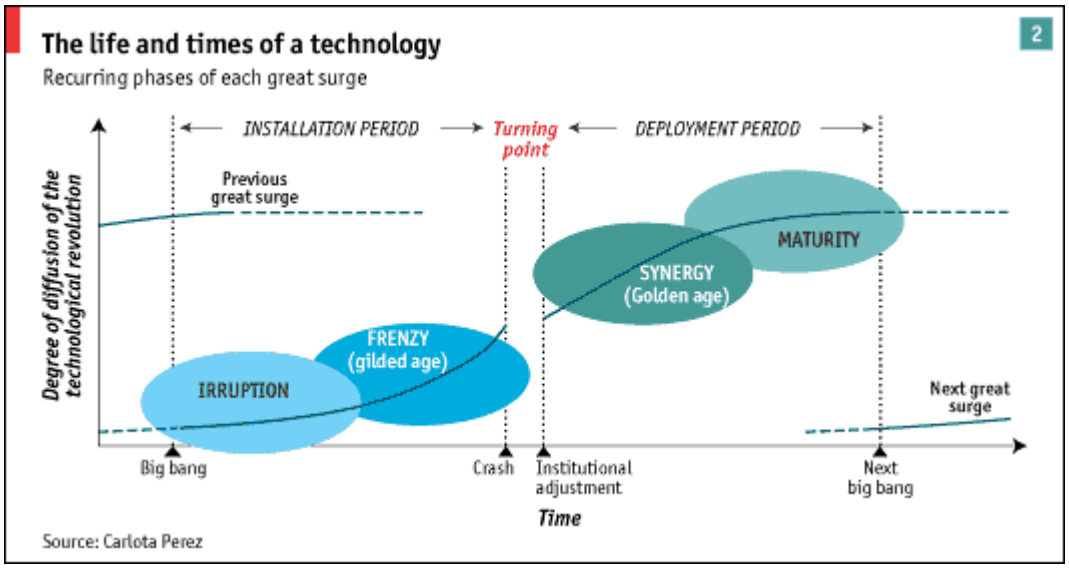
Even more importantly, Moore's law provided the IT industry with a solid foundation for its optimism. In high-tech, the mantra goes, everything grows exponentially. This sort of thinking reached its peak during the internet boom of the late 1990s. Suddenly, everything seemed to be doubling in ever-shorter time periods: eyeballs, share prices, venture capital, bandwidth, network connections. The internet mania began to look like a global religious movement. Ubiquitous cyber-gurus, framed by colourful PowerPoint presentations reminiscent of stained glass, prophesied a digital land in which growth would be limitless, commerce frictionless and democracy direct. Sceptics were derided as bozos “who just don't get it”.

Today, everybody is older and wiser. Given the current recession in IT, the idea of a parallel digital universe where the laws of economic gravity do not apply has been quietly abandoned. What has yet to sink in is that the current downturn is something more than the bottom of another cycle in the technology industry. Rather, as this survey will argue, the sector is going through deep structural changes which suggest that it is growing up or even, horrors, maturing. Silicon Valley, in particular, has not yet come to grips with the realities, argues Larry Ellison, the chief executive of Oracle, a database giant (who at 58 still sports a youthful hairdo). “There's a bizarre belief that we'll be young forever,” he says.

It is not that Moore's law has suddenly ceased to apply. In fact, Mr Moore makes a good case that Intel can continue to double transistor density every 18 months for another decade. The real issue is whether

this still matters. “The industry has entered its post-technological period, in which it is no longer technology itself that is central, but the value it provides to business and consumers,” says Irving Wladawsky-Berger, a senior manager at IBM and another grey-haired industry elder.

Scholars of economic history are not surprised. Whether steam or railways, electricity or steel, mass production or cars—all technological revolutions have gone through similar long-term cycles and have eventually come of age, argues Carlota Perez, a researcher at Britain's University of Sussex, in her book “Technological Revolutions and Financial Capital: The Dynamics of Bubbles and Golden Ages” (Edward Elgar, 2002).



In her model (see chart 2), technological revolutions have two consecutive lives. The first, which she calls the “installation period”, is one of exploration and exuberance. Engineers, entrepreneurs and investors all try to find the best opportunities created by a technological big bang, such as Ford's Model T in 1908 and Intel's first microprocessor in 1971. Spectacular financial successes attract more and more capital, which leads to a bubble. This is the “gilded age” of any given technology, “a great surge of development”, as Ms Perez calls technological revolutions.

The second, or “deployment”, period is a much more boring affair. All the quick bucks have been made, so investors prefer to put their money into the real economy. The leading firms of the new economy become bigger and slower. The emphasis is no longer on raw technology, but on how to make it easy to use, reliable and secure. Yet this period is also the “golden age” of a technology, which now penetrates all parts of society.

These two periods of a technological revolution are separated by what Ms Perez calls a “turning point”—a crucial time for making the choices that determine whether a technological revolution will deliver on its promises. In her book, she concentrates mainly on the social and regulatory decisions needed to allow widespread deployment of new technology. But the same argument applies to technology vendors and customers. To enter their “golden age”, they have to leave their youthful excesses behind and grow up.

A duller shade of gold

This survey will examine how much grey the IT industry (and their leaders' hair) has already acquired. The first three chapters are about technological shifts, and how value is moving from the technology itself to how it is applied. Many of the wares that made the IT industry's fortunes in the installation period are becoming a commodity. To overcome this problem, hardware vendors are developing new software that allows networks of machines to act as one, in effect turning computing into a utility. But the IT industry's most profitable layer will be services of all kinds, such as software delivered as an online service, or even business consulting.

The second half of this survey looks at institutional learning, which has caused the value created by the IT industry to be increasingly captured by its customers. For the first time in its history, the IT industry is widely adopting open standards. Equally important, buyers are starting to spend their IT budgets more wisely. Meanwhile, the industry's relationship with government is becoming closer.

All this suggests that the technology industry has already gone greyish at the temples since the bubble popped, and is likely to turn greyer still. Sooner or later the sector will enter its “golden age”, just as the railways did. When Britain's railway mania collapsed in 1847, railroad shares plunged by 85%, and hundreds of businesses went belly-up. But train traffic in Britain levelled off only briefly, and in the following two decades grew by 400%.

So are the IT industry's best days yet to come? There are still plenty of opportunities, but if the example of the railways is anything to go by, most IT firms will have to make do with a smaller piece of the pie. As this newspaper (then called *The Economist, Weekly Commercial Times, Bankers' Gazette, and Railway Monitor*) observed in 1857: “It is a very sad thing unquestionably that railways, which mechanically have succeeded beyond anticipation and are quite wonderful for their general utility and convenience, should have failed commercially.”

Brad DeLong, an economics professor at the University of California at Berkeley, puts it somewhat more succinctly: “I am optimistic about technology, but not about profits.”

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Modifying Moore's law

May 8th 2003
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Many of the innovations that made the IT industry's fortunes are rapidly becoming commodities—including the mighty transistor

IF GOOGLE were to close down its popular web-search service tomorrow, it would be much missed. Chinese citizens would have a harder time getting around the Great Firewall. Potential lovers could no longer do a quick background check on their next date. And college professors would need a new tool to find out whether a student had quietly lifted a paper from the internet.

Yet many IT firms would not be too unhappy if Google were to disappear. They certainly dislike the company's message to the world: you do not need the latest and greatest in technology to offer outstanding services. In the words of Marc Andreessen of Netscape fame, now chief executive of Opsware, a software start-up: “Except applications and services, everything and anything in computing will soon become a commodity.”

Exactly what is meant by “commoditisation”, though, depends on whom you talk to. It is most commonly applied to the PC industry. Although desktops and laptops are not a truly interchangeable commodity such as crude oil, the logo on a machine has not really mattered for years now. The sector's most successful company, Dell, is not known for its technological innovations, but for the efficiency of its supply chain.

As the term implies, “commoditisation” is not a state, but a dynamic. New hardware or software usually begins life at the top of the IT heap, or “stack” in geek speak, where it can generate good profits. As the technology becomes more widespread, better understood and standardised, its value falls. Eventually it joins the sector's “sediment”, the realm of bottom feeders with hyper-efficient metabolisms that compete mainly on cost.

Built-in obsolescence

Such sedimentation is not unique to information technology. Air conditioning and automatic transmission, once selling points for a luxury car, are now commodity features. But in IT the downward movement is much faster than elsewhere, and is accelerating—mainly thanks to Moore's law and currently to the lack of a new killer application. “The industry is simply too efficient,” says Eric Schmidt, Google's chief executive (who seems to have gone quite grey during his mixed performance at his previous job as boss of Novell, a software firm).

The IT industry also differs from other technology sectors in that its wares become less valuable as they get better, and go from “undershoot” to “overshoot,” to use the terms coined by Clayton Christensen, a professor at Harvard Business School. A technology is in “undershoot” when it is not good enough for most customers, so they are willing to pay a lot for something that is a bit better although not perfect. Conversely, “overshoot” means that a technology is more than sufficient for most uses, and margins sink lower.

PCs quickly became a commodity, mainly because IBM outsourced the components for its first venture into this market in the early 1980s, allowing others to clone the machines. Servers have proved more resistant, partly because these powerful data-serving computers are complicated beasts, partly because the internet boom created additional demand for high-end computers running the Unix operating system.

But although expensive Unix systems, the strength of Sun Microsystems, are—and will probably remain for some time—a must for “mission-critical” applications, servers are quickly commoditising. With IT budgets now tight, firms are increasingly buying computers based on PC technology. “Why pay $300,000 for a Unix server,” asks Mr Andreessen, “if you can get ten Dell machines for $3,000 each—and better

performance?”

Google goes even further. A visit to one of the company's data centres in Silicon Valley is a trip back to the future. In the same way that members of the Valley's legendary Homebrew Computer Club put together the first PCs using off-the-shelf parts in the early 1970s, Google has built a huge computer system out of electronic commodity parts.

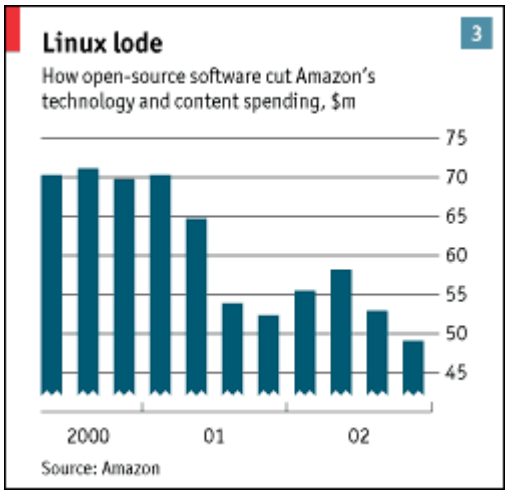
Modern Heath Robinsons

When the two Stanford drop-outs who founded Google, Sergey Brin and Larry Page, launched the company in 1998, they went to Fry's, an electronics outlet where the Valley's hardcore computer hobbyists have always bought their gear. Even today, some of the data centres' servers appear to be the work of tinkerers: circuit boards are sagging under the weight of processors and hard disks, and components are attached by Velcro straps. One reason for the unusual design is that parts can be easily swapped when they break. But it also allows Google's servers to be made more powerful without having to be replaced completely.

What makes it easier for Google to swap off-the-shelf components is that much of its software is also a commodity of sorts. Its servers run Linux, the increasingly popular open-source operating system developed by a global community of volunteer programmers, and Apache, another open-source program, which dishes up web pages.

Because Google has always used commodity hardware and software, it is not easy to calculate how much money it has saved. But other firms that have recently switched from proprietary gear say they have significantly reduced their IT bill. Amazon.com, the leading online shopping mall, for instance, managed to cut its quarterly technology spending by almost $20m (see chart 3).

The most interesting feature of Google's data centre, however, is that its servers are not powered by high-end chips, and probably will not have Itanium, Intel's most powerful processor, inside for some time yet. This sets Google apart among hot Silicon Valley start-ups, whose business plans are mostly based on taking full advantage of the exponential increase in computing power and similar growth in demand for technology.



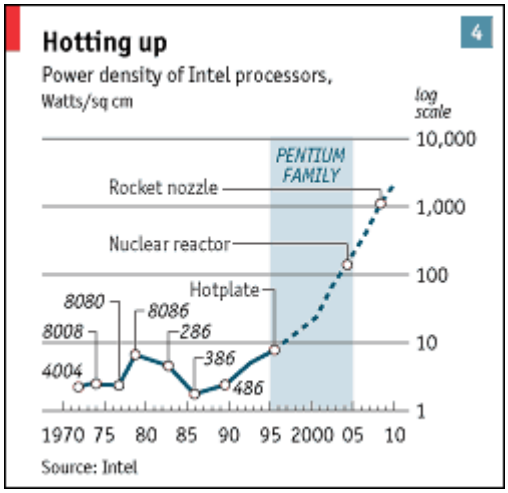
“Forget Moore's law,” blared the headline of a recent article about Google in *Red Herring*, a now-defunct technology magazine. That is surely overblown, but Google's decision to give Itanium a miss for now suggests that microprocessors themselves are increasingly in “overshoot”, even for servers—and that the industry's 30-year race for ever more powerful chips with smaller and smaller transistors is coming to an end.

Instead, other “laws” of the semiconductor sector are becoming more important, and likely to change its underlying economics. One is the fact that the cost of shrinking transistors also follows an exponential upward curve. This was no problem as long as the IT industry gobbled up new chips, thus helping to spread the cost, says Nick Tredennick, editor of the *Gilder Technology Report*, a newsletter. But now, argues Mr Tredennick, much of the demand can be satisfied with “value transistors” that offer adequate performance for an application at the lowest possible cost, in the same way as Google's. “The industry has been focused on Moore's law because the transistor wasn't good enough,” he says. “In the future, what engineers do with transistors will be more important than how small they are.”

This is nothing new, counters Paul Otellini, Intel's president. As chips become good enough for certain applications, new applications pop up that demand more and more computing power, he says: once Google starts offering video searches, for instance, it will have to go for bigger machines. But in recent years, Intel itself has shifted its emphasis somewhat from making ever more powerful chips to adding new features, in effect turning its processors into platforms.

It recently launched Centrino, a group of chips that includes wireless technology. The Centrino chips are also trying to deal with another, lesser-known, limiting factor in chipmaking: the smaller the processors become, the more power-hungry and the hotter

they get (see chart 4). This is because of a phenomenon called leakage, in which current escapes from the circuitry. The resulting heat may be a mere inconvenience for users of high-end laptops, who risk burning their hands or thighs, but it is a serious drawback for untethered devices, where it shortens battery life—and increasingly for data centres as well, as Google again shows.



Cool chips

The firm's servers are densely packed to save space and to allow them to communicate rapidly. The latest design is an eight-foot rack stuffed with 80 machines, four on each level. To keep this computing powerhouse from overheating, it is topped by a ventilation unit which sucks air through a shaft in its centre. In a way, Google is doing to servers what Intel has done to transistors: packing them ever more densely. It is not the machines' innards that count, but how they are put together.

Google has thus created a new computing platform, a feat that others are now replicating in a more generalised form. Geoffrey Moore (no relation), chairman of the Chasm Group, a consultancy, and a partner at Mohr, Davidow Ventures, a Silicon Valley venture-capital firm, explains it this way: computing is like a game of Tetris, the computer-game classic; once all the pieces have fallen into place and all the hard problems are solved, a new playing field emerges for others to build on.

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Moving up the stack

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The network is becoming the computer—and the IT industry's dominant platform

COMPUTING is supposed to be the ultimate form of automation, but today's data centres can be surprisingly busy with people. When an application has to be updated or a website gets more visitors than expected, system administrators often have to install new programs or set up new servers by hand. This can take weeks and often turns out to be more complicated than expected.

Google's data centres, however, look deserted most of the time, with only about 30 employees to look after a total of 54,000 servers, according to some estimates. This is in part because machines doing searches need less care than those running complex corporate applications; but more importantly, the firm's programmers have written code that automates much of what system administrators do. It can quickly change a computer that sifts through web pages into a server that dishes up search results. Without the program, Google would have to hire many more people.

It all goes to show that another law in computing, proclaimed by Gordon Bell, another greying industry legend, still holds true: in IT, the dominant platform shifts every ten years or so. Mainframes, minicomputers, PCs and servers are now likely to be followed by a grid of computers, either within a data centre or as a disparate collection of connected machines. The network will at last be the computer, to paraphrase a slogan coined by Sun Microsystems. Machines will no longer simply be attached to a network: instead, the network will allow them to act as one.

Yet this new platform, which computer scientists like to call “grid computing”, is less about replacing old technology and more about managing the existing gear—another sign that IT is maturing. Merrill Lynch's Steve Milunovich, one of the leading hardware analysts on Wall Street, says that IT has entered the era of “managed computing”. Forrester Research, a high-tech consultancy, has coined the term “organic IT”—a computing infrastructure that is not only built on cheap parts, but is also as adaptive as a living organism. Whatever label the industry settles for, the race to lead in the next round of computing is already on. The new platform gives those threatened by commoditisation a chance to differentiate themselves by moving up the technology stack to a potentially more lucrative layer.

There is every incentive for HP, IBM, Microsoft and Sun, as well as a raft of start-ups, to encourage this shift, but there is also a real need for a new platform. Computing has certainly got faster, smarter and cheaper, but it has also become much more complex. Ever since the orderly days of the mainframe, which allowed tight control of IT, computer systems have become ever more distributed, more heterogeneous and harder to manage.

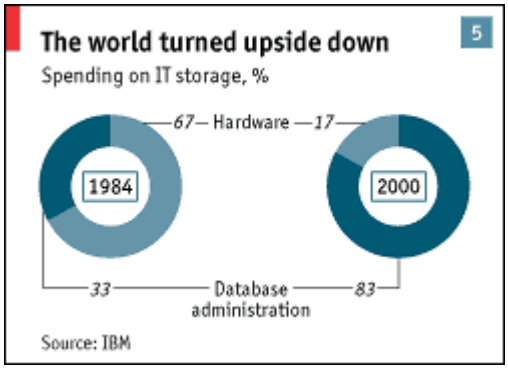
Managing complexity

In the late 1980s, PCs and other new technologies such as local area networks (LANs) allowed business units to build their own systems, so centralised IT departments lost control. In the late 1990s, the internet and the emergence of e-commerce “broke IT's back”, according to Forrester. Integrating incompatible systems, in particular, has become a big headache.

A measure of this increasing complexity is the rapid growth in the IT services industry. According to some estimates, within a decade 200m IT workers will be needed to support a billion people and businesses connected via the internet. Managing a storage system already costs five times as much as buying the system itself, whereas less than 20 years ago the cost of managing the system amounted to only a third of the total (see chart 5).

What is more, many of today's IT systems are a patchwork that is inherently inefficient, so firms spend 70-90% of their IT budgets

simply on keeping their systems running. And because those systems cannot adapt quickly to changes in demand, companies overprovide. They now spend almost $50 billion a year on servers, but the utilisation rate for these computers is often below 30%.



Besides, complexity is bound to increase, predicts Greg Papadopoulos, Sun's chief technology officer. Today, the electronics to hook up any device to the network cost about $1. In ten years' time, the price will be down to one cent. As a result, he says, the number of connected things will explode, and so will the possible applications. For example, it will become practical to track items such as razor blades (10% of which apparently disappear on their way from the factory to the shop).

When things get too complicated, engineers usually add a layer of code to conceal the chaos. In some ways, the current shift in computing is the equivalent of what happened when cars became easy to use and drivers only had to turn the key instead of having to hand-crank the engines. In geek speak, adding such a new layer is called “raising the level of abstraction”. This happened when PC operating systems first hid the nuts and bolts of these computers and gave them a simple user interface, and it is happening now with the new platform, which is already being compared to an operating system for data centres or computing grids.

Just like Google's management program, this grid computing software (only half-jokingly called “griddleware” by some) automates much of the work of system administrators. But it is also supposed to serve a higher purpose: “virtualisation”. Put simply, this means creating pools of processing power, storage capacity and network bandwidth. A data centre, or a collection of machines on a network, thus becomes a virtual computer whose resources can be allocated as needed. The ultimate goal is that managed computing will become rather like flying a modern jet plane: IT workers will tell the system what kind of applications it should run, and then deal only with exceptions.

Although the rivals in this new field are pretty much on the same technological track, their strategies are different. Some of the numerous start-ups already have working products—and no hidden agenda, says Mr Andreessen, of Opsware, the leading newcomer: “We don't need to push our customers also to buy other stuff from us.” The incumbents, on the other hand, want the new software layer to protect their old business models as well. HP's Utility Data Centre (UDC) initiative and Sun's N1 plan are supposed to help these firms sell their profitable hardware. IBM's “autonomic computing” effort goes hand-in-hand with Big Blue's IT services business. And Microsoft's Dynamic Services Initiative (DSI) is tightly linked with its Windows operating system.

Yet despite such arm-twisting, customers are unlikely to bet solely on newcomers. Only the biggest vendors will really be able to deliver managed computing, argues Shane Robinson, the chief technology officer of HP, which has much riding on the new platform. According to the Gartner Group, a consultancy, HP is leading in virtualisation, and views management software as its big opportunity.

Once thing is clear: once all the technical challenges of grid computing have been overcome, hardware will have become a true commodity. Machines, storage devices and networks will lose their identity and feed into pools of resources that can be tapped as needed. This liquefaction of hardware, in turn, will allow computing to become a utility, and software a service delivered online.

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Techniques, not technology

May 8th 2003
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IT firms hope to turn the dismal science into a profitable business

TO MOST people the world is round, but geeks often see it as a stack of layers. In corporate computing, it starts with the hardware, on top of which sits the operating system, then the database, the applications and finally IT services. When their layer is getting commoditised, technology companies tend to move up the stack, where more money can be made.

In their quest for greener pastures, IT firms have reached new heights by moving into cutting-edge economics. Both HP and IBM have opened labs to conduct research on the subject, in the hope that this will help them to offer their customers more sophisticated services.

To be sure, economics has had its place in the IT industry for some years now. HP, for instance, already uses software that simulates markets to optimise the air-conditioning systems in its utility data centres. And IBM's Institute for Advanced Commerce has studied the behaviour of bidding agents, in the hope of designing them in such a way that they do not engage in endless price wars.

Now HP is reaching even higher, with experimental economics. As the name implies, researchers in this field set up controlled experiments with real people and real money to see whether economic theories actually work. Perhaps surprisingly, it seems that they do, as demonstrated by the work of Vernon Smith of George Mason University in Virginia. (Mr Smith is considered the founding father of this field and won last year's Nobel prize in economics.)

Secret agent

HP goes further. The firm's team of five researchers does not test economic theories, but tries to create “novel mechanisms to improve the fluidity of interactions in the information economy”, says Bernardo Huberman, head of the group. In everyday language, the researchers are working on clever tools that make it easier to negotiate online, establish reputations and make forecasts.

Mr Huberman's group already has something to show for its efforts. It has developed a methodology for predicting uncertain events using a small group of individuals. First, they find out about their subjects' attitudes towards risk and their ability to forecast a given outcome. They then use this information to weight and aggregate their predictions of events, resulting in fairly accurate forecasts.

These tools will first be used inside the company. The top management of one of HP's divisions is already testing the forecasting methodology to predict its revenue. But ultimately the firm wants to find outside customers for its research findings. American intelligence agencies, such as the CIA, have already shown interest. They need better tools to weigh the opinions of those who analyse incoming information.

So at what point will firms such as HP and IBM have moved far enough up the stack to cease to be traditional IT vendors and become service providers or consultancies? Most analysts agree that this metamorphosis is still some way off. But it already seems certain that in future IT firms will increasingly be in the business of techniques rather than technology.

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At your service

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Despite early failures, computing will eventually become a utility

MARC BENIOFF (not a grey hair in sight) is not afraid to mix religion and business. In late February, the practising Buddhist and chief executive of salesforce.com, a San Francisco start-up, invited 200 customers and friends to a benefit concert featuring David Bowie, with proceeds going to the Tibet House, a New York cultural centre whose patron is the Dalai Lama. But Mr Benioff also used the event to get his firm's message across: “Freedom from software”.

The unusual mixture raised some eyebrows, but in a way Mr Benioff's technology does indeed dispense with software. Clients can access the firm's service via a web browser, which saves them having to install a complicated customer relationship management (CRM) program on their own computers. Some 6,300 customers in 110 countries have already signed up for it, generating $52m in the past fiscal year, says Mr Benioff.

Sceptics maintain that salesforce.com is not so much the leader of a new trend as a lone survivor of better times. Hundreds of application service providers (ASPs) were launched late in the dotcom boom, but few others have succeeded. This is mainly because with existing technology it is difficult to make money on a high-end software service.

But not for much longer. Thanks to the technological trends outlined in the previous two articles, computing is becoming a utility and software a service. This will profoundly change the economics of the IT industry. “The internet spells the death of the traditional software business model,” predicts Mr Benioff.

This is not as earth-shattering as it sounds. As other technologies matured, buyers were given more choice in how to acquire them, says IBM's Irving Wladawsky-Berger. In the early days of electricity, for instance, most firms had to have their own generators. Now most can get their power from the grid. Similarly, he says, it would be surprising if in 20 years' time most of IT was not outsourced.

Traditionally, companies wanting to invest in computer systems did not have much choice: they had to build and operate their own. To be sure, they could outsource the work to companies such as EDS and IBM Global Services, but in technical terms that did not change much, because such firms usually operate dedicated computer systems for each customer.

There must be a better way

When it comes to enterprise software, in particular, this way of delivering technology creates a somewhat perverse set of economics. Software is a service at heart, albeit an automated one, but it is sold much like a manufactured good. Customers have to pay large sums of money up front, bear much of the risk that a program may not work as promised, and cannot readily switch vendors.

IT firms, for their part, have to spend a lot of resources on marketing and distribution, rather than concentrating on developing software that works well and is easy to use. Network effects and Wall Street make matters worse. In many markets it is a great advantage to be first, so vendors are tempted to release programs even if they are still riddled with bugs. And because equity analysts rightly consider software firms a risky investment, such firms must grow quickly to justify their relatively high share prices, pushing them to sell more programs than customers need.

All this explains several peculiarities of the software business. One is the fact that many of the licences sold are never used, a phenomenon known as “shelfware”. More importantly, many software firms have grown so fast, often mortgaging the future, that they collapse when they reach $1 billion in annual

revenues, sometimes never to recover. Then there is the end-of-quarter rush, spurring many firms to do anything to get deals signed and meet analysts' expectations.

The need to grow quickly also explains why IT industry leaders are such a “truly extraordinary cast,” in the words of Louis Gerstner, who was IBM's chief executive for eight years. “They make outrageous remarks, they attack one another publicly with great relish,” he writes in his book “Who Says Elephants Can't Dance?” (HarperBusiness 2002). Bosses of software firms, in particular, need to demonstrate that they will pursue growth at almost any price—which explains why they are often paired with grey-haired chief financial officers as a calming counterweight.

Mr Gerstner, who has spent most of his career outside the IT industry, does not point fingers, but examples of the industry's “bizarre practices”, as he puts it, are not hard to find. The most obvious one is Oracle, a database giant which had a near-death experience in 1991, having cut some reckless deals to meet expectations. The firm is also known to have released software prematurely, most recently its e-business suite. And it is run by Larry Ellison, arguably the most colourful boss in the industry, and Jeff Henley, the archetype of a grandfatherly CFO. To be fair, it must be said that the company has matured greatly in recent years.

In future, technology itself could lead to a better balance in the sector as a whole. The internet made it possible to run ASPs such as salesforce.com, but it also enabled hardware makers to monitor servers and bill customers remotely on the basis of the average use per month. This is the sort of thing HP does with its high-end Superdome machines.

As data centres become automated, computing will increasingly turn into a true utility. With the management software described in the previous article, firms can share computing resources, which means they always have enough of them but pay only for what they actually use. They no longer need to run their own dedicated machines, any more than they need to run their own power plants.

Waiting for web services

For software truly to become a service, however, something else has to happen: there has to be wide deployment of web services. These are not, as the term might suggest, web-based offerings such as salesforce.com, but a standard way for software applications to work together over the internet. Google, for instance, also offers its search engine as a web service to be used in other web offerings, such as Googlefight, a site where surfers with time to waste can find out which of two related key words produces more search results.

Ultimately, experts predict, applications will no longer be a big chunk of software that runs on a computer but a combination of web services; and the platform for which developers write their programs will no longer be the operating system, but application servers. These are essentially pieces of software that offer all the ingredients necessary to cook up and deliver a web service or a web-based service such as salesforce.com.

Just as with management software for data centres, vendors are already engaged in a battle for dominance. Ranged on one side is Microsoft with its .NET platform (although it has recently toned down the use of this name). Jostling on the other are BEA, IBM, Oracle and Sun, with different versions of technology based on the Java programming language.

Both camps are likely to coexist, but the economics of software services will be different. Most important, vendors will be much more motivated than previously to keep their promises. “In the old world, we didn't care if you were up and running, we only cared about the numbers,” says Mr Benioff, who cut his professional teeth at Oracle. “Now, I get paid only if my customers are happy.”

A different kind of grey

Shifting more of the implementation risk to vendors will profoundly change the nature of the software business. Wall Street will have to view software firms more like utilities, which tend to grow rather slowly if steadily. And, perish the thought, software bosses could get more boring. The tone in the industry may no longer be set by people such as Mr Ellison, but by more prudent and cerebral chief executives such as SAP's Henning Kagermann.

Incumbents will not find it easy to manage this transition: they will have to wean themselves from the heroin of growth. Of the industry heavyweights, Oracle has arguably travelled farthest, having put most of its programs online as early as 1998. As yet, this part of its business contributes only a tiny share of the total revenue, but Mr Ellison expects it to grow quickly. He also acknowledges that the time for visionary leaders like himself may well be over: “It is mainly going to be about execution.”

On the vision front, however, IBM has recently bested Mr Ellison. Last October, Samuel Palmisano, now the firm's chief executive, announced that IBM was making a $10-billion bet on what he called “on-demand computing”—essentially an effort to turn IT from a fixed into a variable cost. American Express has already signed a seven-year, $4 billion contract with IBM which allows the credit-card company to pay only for the IT resources it needs.

Yet the American Express contract still looks more like a classic outsourcing deal with flexible pricing. If computing is to become truly on-demand, much remains to be done, says Mr Wladawsky-Berger, who leads IBM's initiative. Getting the technology right is probably the easy part. The more difficult problem is persuading the industry to settle on open standards.

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The fortune of the commons

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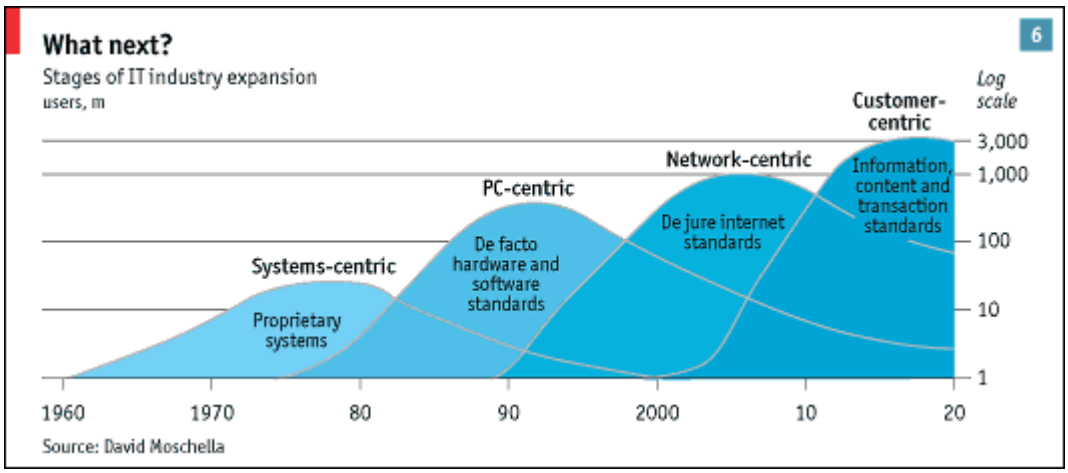

For the first time, the IT industry is widely adopting open standards—thanks to the internet

BUYING a screw is easy today, if you know what kind you want. But in America in the middle of the 19th century, such a purchase could get quite complicated. Most screws, nuts and bolts were custom-made, and products from different shops were often incompatible. The craftsmen who made them liked it this way, because many of their customers were, in effect, locked in.

Yet it was one of these craftsmen's leaders who set America's machine-tool industry on the path of standardisation. In 1864, William Sellers proposed a “uniform system of screw threads”, which later became widely adopted. Without standardised, easy-to-make screws, Mr Sellers' argument went, there could be no interchangeable parts and thus no mass production.

Not every technology sector had such far-sighted leaders. But railways, electricity, cars and telecommunications all learned to love standards as they came of age. At a certain point in their history, it became clear that rather than just fighting to get the largest piece of the pie, the companies within a sector needed to work together to make the pie bigger.

Without standards, a technology cannot become ubiquitous, particularly when it is part of a larger network. Track gauges, voltage levels, pedal functions, signalling systems—for all of these, technical conventions had to be agreed on before railways, electricity, cars and telephones were ready for mass consumption. Standards also allow a technology to become automated, thus making it much more reliable and easier to use.

Today, the IT industry is finally getting the standards religion. In fact, standards have always played an important role in high-tech, but they were often proprietary. “For the first time, there are true standards to allow inter-operability—de jure standards not controlled by a vendor,” points out Steve Milunovich, the analyst at Merrill Lynch.

This is not simply a question of protocols and interfaces. Entire pieces of software are becoming open standards of sorts. Operating systems, for instance, are technically so well understood that they can be developed by worldwide virtual communities of volunteer programmers, as with Linux, the most popular piece of open-source software.

The taming of the screw

It would be hard to overestimate the importance of this shift. So far, just as in the early days of the screw, the name of the game in IT has been locking in customers, making it costly for them to switch from one brand of technology to another. In some ways, although IT firms are the epitome of mass production, when it comes to standards they are still stuck in the craftsmen era, which explains in large part why they have been so amazingly profitable.

Network effects make it even more attractive to control a technology, argue Carl Shapiro and Hal Varian, two economics professors, in “Information Rules”, still the best read on the network economy (Harvard Business School Press, 1998). If the value of a technology depends not just on its quality but also on the number of users, positive feedback can help one firm to dominate the market. For example, the more people are already connected to a data network using a particular transmission standard, the more people will see the point of hooking up to it.

These network effects also explain why the IT industry in the 1980s already started to move away from completely proprietary technology, the hallmark of the mainframe era. Microsoft, in particular, figured out how to strengthen feedback loops by encouraging other software firms to develop applications for its operating system. This kind of openness made Windows a standard, but users were still locked in.

Now it seems that, thanks to the internet, the IT industry has entered a positive feedback loop in favour of open standards. Looking back, says Mr Wladawsky-Berger, historians will say that the internet's main contribution was to produce workable open standards, such as TCP/IP, its communication protocol, or HTML, the language in which web pages are written. The internet has also made it much easier to develop standards. Most of the work in the Internet Engineering Task Force (IETF) and the World Wide Web Consortium (W3C), the internet's main standards bodies, is done online. Global open-source communities are able to function because their members can communicate at almost no cost using e-mail or other online tools.

The success of these groups has also inspired traditional IT companies to create their own open-source-like bodies. Sun, for instance, launched the “Java Community Process”, or JCP, to develop its Java technology. But because Sun is worried that its standard could splinter, just as that for the Unix operating system did, the firm has installed itself as the JCP's benevolent dictator.

Sun is not the only firm to have learned that creating standards can be good for business—for instance, to commoditise a complementary good or to prevent a single firm from controlling an important technology. If operating systems become more of a commodity, reason IBM and others who back Linux, this will make customers spend more money on other products and weaken both Microsoft and Sun.

A new incentive

The emergence of web services has concentrated minds wonderfully on developing open standards. Displaying an unprecedented degree of co-operation, the computer industry is developing a host of common technical rules that define these new kinds of online offerings. Hence the proliferation of new computer-related acronyms such as XML, SOAP, UDDI, WSDL and so on.

To be sure, standardising web services is not always easy. As standardisation moves into more complex areas, such as security and the co-ordination of different offerings, consensus seems to be harder to achieve. Incumbents in particular have started to play games to give their wares an advantage. They are also trying to lock in customers by adding proprietary extensions to the standards mix.

Most worrying, however, is the possibility that software firms will have to pay if they implement web-services standards. Most standards bodies currently allow firms to continue owning the intellectual property they contribute as long as they do not charge for it. But the more involved that standards for web services become, the greater the pressure that firms should be able to charge for the use of the patents they have invested in.

Smaller web-services firms have already started ringing the alarm bells. The IT industry is at a crossroads, says Eric Newcomer, chief technology officer of Iona Technologies. One road leads to a truly standardised world in which companies are able to reap all the benefits of web services. The other road “leads back to yesteryear, where proprietary systems ruled the day”.

The controversy points to a more general problem with technology standards: where to draw the line between the IT commons and the areas where firms should compete with proprietary technology. If the

commons area is too large, there might not be enough incentive to innovate. If it is too small, incompatibilities could keep web services from becoming a standard way for computer systems to communicate.

This dividing line is flexible, particularly when it comes to something as malleable as software. But in the long run, says Ken Krechmer, a telecommunications-standards expert, information technology itself will help to reconcile standardisation and innovation, because it will increasingly turn standards into “etiquettes”.

Systems such as railways or electricity and telephone networks, Mr Krechmer argues, need “compatibility” standards—clear specifications on how they can interoperate. But information technology is “adaptive”, meaning that as devices become more intelligent, they can negotiate which standard they want to use to communicate. What is needed is a “meta-protocol”, regulating the back and forth.

Faxes already work this way. Before transmitting anything, they negotiate over the speed at which they want to communicate. The extensible markup language (XML), the lingua franca underlying most web-services standards, also enables etiquettes. If the computer systems of two companies want to exchange the XML document for an order, they can first come to a common understanding of what the file's information means. Etiquettes thus allow for proprietary innovation while ensuring compatibility, argues Mr Krechmer.

The customer is king

In the end, though, how proprietary or how open the IT industry is likely to be will depend on its customers—who seem increasingly keen on open standards. “Vendors no longer lock in customers,” says Robert Gingell at Sun. “Now it's customers locking in vendors—by telling them which standards they have to support.”

What is more, customers themselves are making their voices heard more clearly in the standards-setting process. The Liberty Alliance, an industry group developing specifications on how to manage identities and personal information online, was originally launched by Sun as a counterweight to Microsoft's Passport service, but is now driven by large IT users such as United Airlines, American Express and General Motors.

And it is not just because they hate to get locked in that customers get involved. Increasingly, says William Guttman, an economics professor at Carnegie Mellon University, standards must take account of public-policy issues such as privacy. Without the input of users, governments and academics, as well as IT firms and their customers, specifications risk becoming irrelevant, Mr Guttman maintains. He himself has launched an inclusive group called the Sustainable Computing Consortium (SCC), which among other things is looking for ways of measuring software quality.

Customers, in short, are getting more sophisticated all round—but most notably when it comes to investing in IT.

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Cold killer application

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The IT industry's customers are demanding more bang for fewer bucks

THE internet bubble and the subsequent accounting scandals had at least one merit: most people now know what chief information and chief financial officers do. In years to come, they will have to get used to a combination of both jobs: the CFO of IT.

Yet for now, hardly anybody has heard of such a thing. Marvin Balliet, whose official title at Merrill Lynch is “CFO, Global Technology & Services”, says that even internally he has a lot of explaining to do. Simply put, his job is to make sure that the bank's annual IT budget of more than $2 billion is wisely spent. This means bridging two worlds: IT people on the one hand and business units on the other. The business people need to know what is technically possible, and the IT lot what is financially feasible.

Mr Balliet, and the growing number of managers with similar titles, are living proof that technology buyers too are on a steep learning curve. Companies that invested recklessly during the bubble years, and stopped when it burst, are at last getting ready to make more rational technology decisions. “Capitalism has made its entry into IT,” says Chris Gardner, co-founder of iValue, a consultancy, and author of “The Valuation of Information Technology” (John Wiley, 2000).

Yet this is not just a predictable reaction to the boom-and-bust cycle. There is big money at stake. After almost 40 years of corporate IT, technology investment now often makes up more than half of capital spending. As John O'Neil, chief executive of Business Engine, a project-management firm, puts it: “IT can't hide any more.”

Why should it have wanted to hide in the first place? Part of the reason is that IT projects are usually highly complex affairs that change constantly and tend to get out of control. “Traditionally, managing technology was magic, with quality and performance delivered only through incredible feats of highly skilled people,” says Bobby Cameron, who cut his professional teeth in the days of punch cards and is now an analyst with Forrester Research.

Even today, IT departments, particularly in America, are often magic kingdoms full of technology wizards where basic business rules do not seem to apply. Investment decisions are generally guided by gut feeling and by the latest wheeze, rather than by the firm's overall business strategy and sound financial analysis.

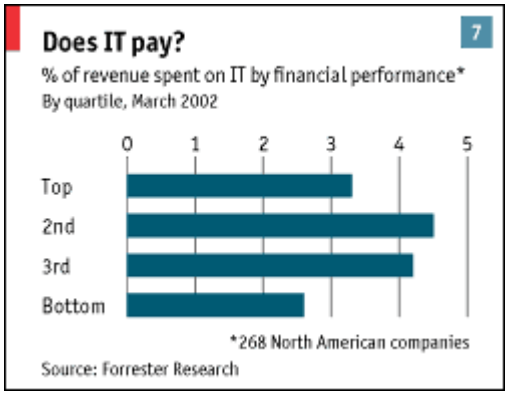
This is not just the fault of IT people who cherish their role as lone gurus, but also of their bosses who often abdicate responsibility to technologists and set no clear rules on how to make decisions. Business units, for their part, often start too many projects and do not take responsibility for their success or failure. After all, in most companies, IT costs are not directly allocated to those who incur them.

Whose job?

This set-up creates permanent tension between the IT departments and the business units, which is why most CIOs do not survive in their jobs for more than two years. It is also the main reason why so many IT projects are over budget and late. And when they are up and running at last, they often turn out to be obsolete already; or they do not get used because they take no account of how employees actually do their work.

High-tech consultancies estimate that more than half of all IT projects go wrong. They may have an incentive for exaggerating the failure rate (the more problems there are, the greater the perceived need for consultancy), but there is no question that

much IT investment is wasted. To complicate matters, firms appear to differ widely in how efficiently they invest in IT. Looking at the relationship between the technology budgets and the financial results of 268 American firms, Forrester recently found that those that spend the most on IT are not necessarily the best performers (see chart 7).



Such statistics, along with their own unhappy experiences, have led many firms to rethink the way they spend their IT dollars. Using complex valuation methods, they try to work out beforehand whether IT projects are likely to return the investment. “They now have to compete for capital with other forms of spending,” says Chris Lofgren, chief executive of Schneider National, an American trucking and logistics company.

The trend has already generated a cottage industry for tools to calculate return on investment (ROI) and similar financial measures. One of the most sophisticated of these is offered by iValue. This start-up assesses all possible effects of an IT project—from customer loyalty and likely adoption rates to the company's share price—by building complex economic simulations for its customers, which include Citibank's Global Securities arm and Baan, a software firm.

Other tools allow firms to budget for IT projects, keep track of them and allocate the costs. Business Engine operates a web-based service that brings together all the information about a project and allows everybody involved to collaborate. One of the reasons why in the past there was no real dialogue between the business and the IT sides was a lack of good data, explains Business Engine's Mr O'Neil.

The firm, which has its roots in the defence industry, also helps companies with a technique at the cutting edge of technology management: balancing IT projects in the same way that many investors optimise their portfolios. Like different types of financial assets, IT projects can be classified according to risk and potential returns, allowing firms to pick a selection that fits their particular business strategy.

Peter Weill, a professor at MIT's Sloan School of Management, suggests that firms divide up their IT projects among four buckets representing different management objectives: cost reduction, better information, shared infrastructure and competitive advantage. Risk-averse and cost-conscious companies should have more projects in the first two buckets, whereas firms that put a premium on agility and are not afraid of failures should weight their portfolio in favour of the other two categories.

Who calls the shots?

All this fancy footwork, however, says Mr Weill, is not worth much without effective IT governance, by which he means rules that specify who makes the decisions and who is accountable. If his study of 265 companies in 23 countries is representative, most IT decisions—and not just those on geeky subjects such as picking the right IT infrastructure or architecture—are currently taken by technologists.

Some companies have already started to re-balance their governance. Merrill Lynch, for example, has put business people in charge of their technology portfolio. One of the things they have to do to get a project approved is to calculate its cost over five years, which they have a strong incentive to get right because these costs are charged back to a project's sponsors. They also have to re-assess every quarter whether it is still viable. Financial markets can change very rapidly, so a project begun in 2000 to increase the capacity to process Nasdaq trades, for example, no longer makes much sense today.

Schneider National goes even further. It has an IT steering committee that acts like a venture-capital firm, screening all proposed IT projects and picking those with the best business plans. But the firm's in-house entrepreneurs do more than produce good ROI numbers. They also point out the necessary changes in business processes and organisation to ensure that employees are willing to use the new IT system. “People can undermine any technology,” says Mr Lofgren.

Given the chill in the industry, it is no wonder that companies everywhere are rationalising their existing IT infrastructure and keeping purse strings tight. General Motors, for instance, has reduced the number of its computer systems from 3,000 to 1,300 by consolidating applications and servers. Merrill Lynch has cut its annual IT budget from $3 billion to $2 billion, mostly through what UBS Warburg, another investment bank, calls “cold technologies”—the sort that do not create new revenues for IT firms and

often actually reduce spending. One of these is Linux, the free open-source operating system. Another is web services, which allow companies to integrate existing gear cheaply, thus giving new life to old, “legacy”, systems such as mainframes.

No wonder, either, that companies spend their IT dollars differently from the way they used to. Software vendors, in particular, can no longer depend on quick multi-million-dollar deals, but must work hard to get much smaller contracts. Customers want bite-sized projects with quick returns, and increasingly pay up only if they are successful.

The danger of this new buying pattern is that companies may miss out on important long-term “architectural” investments, says John Hagel, a noted IT consultant. If vendors want IT spending to pick up again, they will have to concentrate more of their efforts on selling to business people rather than technologists. Yet many firms are “still stuck in the old world”, he complains.

Luckily for IT companies, there is one customer that is spending more now than it did during the internet bubble: government. And that is only one of the reasons why the IT industry is becoming more involved in Washington, DC.

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Regulating rebels

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Despite its libertarian ideology, the IT industry is becoming increasingly involved in the machinery of government

EVEN among the generally libertarian Silicon Valley crowd, T.J. Rodgers stands out. In early 2000, when everybody else was piling into the next red-hot initial public offering, the chief executive of Cypress Semiconductor, a chipmaker, declared that it would not be appropriate for the high-tech industry to normalise its relations with government. “The political scene in Washington is antithetical to the core values that drive our success in the international marketplace and risks converting entrepreneurs into statist businessmen,” he wrote in a manifesto published by the Cato Institute, a think-tank.

A laudable sentiment, but in real life things are more complicated than that. In a sense, Silicon Valley is a creation of government. Without all the money from the military establishment, the region around San Jose would probably still be covered with fruit orchards. In any case, Mr Rogers's worst fears appear to be coming true. America's technology industry is becoming more and more intertwined with government. It has realised that the machinery of government in Washington can greatly influence its growth and profitability, and is becoming increasingly involved in lobbying. Conversely, the American government has become keenly aware of IT's crucial importance for the nation's well-being, heightened by the new emphasis on homeland security.

This should not come as a surprise, argues Debora Spar, a professor at Harvard Business School. “When technologies first emerge, there is a rush away from government and a surge of individualism. Over time, however, the rebels tend to return to the state,” she writes in her book “Ruling the Waves” (Harcourt, 2001). And if the rebels become too powerful, the state tries to rein them in.

Take the development of the telegraph, in which government played an important role even though it was mainly driven by private firms. In the early days, the state protected the patents of Samuel Morse (who originally wanted government to fund and control the technology he had invented in 1835 because “this mode of instantaneous communication must inevitably become an instrument of immense power”). Later, the US Congress passed several laws regulating Western Union, the company that had monopolised telegraphy.

The reason public rules usually find their way into a technology, Ms Spar argues, is because government can protect property rights and restore order. But it also happens when a technology becomes widely used. “We cannot say the internet will have a huge influence on everyday life, and also say ‘Hey Washington, keep out of it',” says Les Vadasz, a senior manager at Intel (due to retire next month).

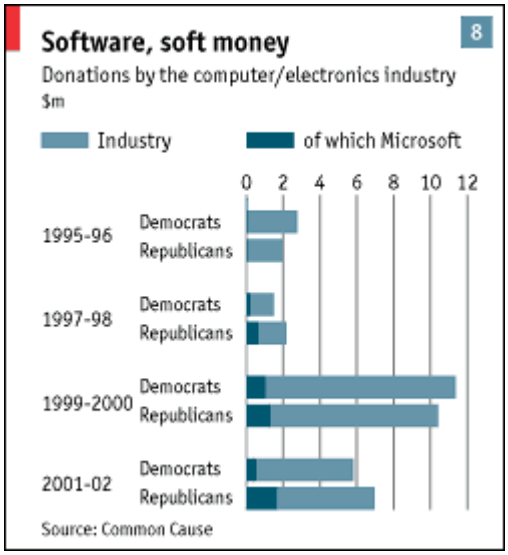
Discovering a conscience

The chipmaker never had any ideological qualms about co-operating with government. In that sense, it has always been a mature company. Intel benefited from government money in the 1980s when it came under competitive pressure from Japanese manufacturers. Other Silicon Valley firms, too, owe much to the state. Oracle, for instance, grew out of a consulting job for the CIA, and the taxpayer stumps up for over a fifth of its orders.

The Valley as a whole, however, did not develop a political conscience until 1996, when it successfully campaigned against a California ballot initiative that would have made shareholder lawsuits much easier. This alerted the region's leaders to the need to get more involved to defend their interests, leading to the creation of such groups as TechNet, a lobbying and fund-raising organisation.

This environment also provided fertile ground for having a go at Microsoft. The antitrust case against the company might never

have been brought without its competitors stirring up the trustbusters. The trial itself led to mass lobbying by both sides, as well as a rise in campaign-finance contributions. In fact, Microsoft has become one of the biggest donors to the Republican Party (see chart 8).



Now that the IT industry is in recession, the issues have changed. High-tech has discovered the Washington pork-barrel, a development that the Cato Institute calls a “Digital New Deal”. At the top of the wish list is much more widespread high-speed internet access, or broadband. The number of connections has recently risen faster than expected, but companies such as Intel and Microsoft still think government should do something to push broadband, which would increase demand for high-tech goods and services. Security and privacy issues too are a high priority.

Yet the sector's most important political battle will be over property rights. Two conferences in the past couple of months, one in Silicon Valley and one near it, highlighted the issues. “The law and technology of digital-rights management”, was the theme of the event at the University of California at Berkeley. “Spectrum policy: property or commons?”, asked the organisers at Stanford University.

To be sure, in technical terms intellectual property and radio spectrum are altogether different issues, but they pose similar policy challenges. In both cases technology is unsettling the status quo: the balance in copyright and the bureaucratic allocation of frequencies. And in both cases the main question now is how to organise markets to maximise innovation and investment.

The corporate interests battling it out in Washington naturally take a less lofty view. Hollywood wants nothing less than anti-piracy systems built into every electronic device, and is threatening to use its formidable lobbying power to get the legislation through if the IT industry does not comply voluntarily. Silicon Valley, worried that it will have to include government-dictated technology in its gear, has launched a huge lobbying campaign.

Battle for survival

The outcome of this battle, many industry experts argue, will determine to a large extent how fast the IT industry will grow. Without a balanced solution, online media and broadband are unlikely ever to take off. If its wares are not sufficiently protected online, Hollywood will not make them available. And if electronic devices are put into a technological straitjacket, consumers will not use them.

The dispute surrounding the allocation of frequencies, triggered by the success of wireless internet access, known as WiFi, might turn out to be even more important. The incumbents that currently own wide swathes of the radio spectrum, such as TV stations and cellular carriers, will fight tooth and nail to defend the status quo. Silicon Valley, for its part, is pushing for more of the spectrum to become a commons for everybody to use, which is what happens with WiFi.

All this may sound like Washington business as usual, but the American government has definitely acquired a new interest in high-tech. Even before the terrorist attacks on September 11th 2001, it had identified the internet as part of the nation's critical infrastructure in need of better protection. Now IT is playing a central role in the war on terrorism and homeland security, both as a means to gather information and to improve the connections between different government agencies.

Shortly after September 11th, Congress passed the Patriot Act, which gives law enforcers new surveillance powers, such as monitoring internet traffic without a court order. More recently, the Bush administration launched its Total Information Awareness (TIA) initiative, a highly controversial system developed by the Pentagon to sift through the electronic transactions of millions of people to spot suspicious activity.

All this makes government a key customer rather than just a big buyer. Most large enterprise software firms have launched “homeland security” initiatives in the hope of providing the federal government with technology to integrate its disparate databases to allow it to identify possible terrorists.

Vendors have also made their top engineers and researchers available as advisers, and are adapting their plans to reflect the fact that security has become the main priority. Some in Silicon Valley now liken the climate to that of the late 1970s, when government and military contractors employed more than 20% of the region's workforce.

Will the IT industry ever become as intertwined with government as, say, the car or media sectors? Nobody knows; but if it does, says Google's Eric Schmidt, high-tech will lose its innovative spark and, just like other sectors, turn to rent-seeking.

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Déjà vu all over again

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If history is any guide, the IT industry's future will be about services and customer power

ONE would expect Eric Schmidt, one of Silicon Valley's leading lights, to have an oversized inner geek. But these days, he sounds more like a closet historian. He enjoys talking, for instance, about how America's transcontinental railroad in the 1860s was built on debt, a bubble and scandals. Another favourite topic is the laying of the first transatlantic cable in that period, a seemingly impossible mission.

To Mr Schmidt, reading and thinking about history is a kind of redemption, for himself as well as for the high-tech industry: “We believed that the bubble would never end. We were wound up in a state of hubris.” But of course, he says, it was déjà vu all over again: “People in high-tech didn't take any history classes.”

If history is any guide, what does it tell us about the way the IT industry will evolve? As a technological revolution matures, its centre of gravity tends to shift from products to services. In railways, for instance, equipment makers and train operators struggled, but lots of money was made by firms that used the railway infrastructure to offer new kinds of services, explains Brad DeLong at the University of California at Berkeley. One example was Sears, Roebuck & Co., which brought city goods to rural areas by mail order, offering a cheaper alternative to high-priced rural stores. In the same way, after the radio bubble, it was not the makers of the hardware that benefited most from the new medium, but broadcasters such as CBS.

A similar shift is bound to take place in the IT industry, predicts Geoffrey Moore of the Chasm Group. He says the sector's traditional business models are past their prime. Software firms, for instance, have made much of their money from shrink-wrapped products and platforms such as operating systems and databases. Increasingly, selling services of all kinds would be a better business to be in.

But it is not just IT firms that are becoming service providers, writes David Moschella in his recent book, “Customer-Driven IT” (Harvard Business School Press, 2003). IT customers themselves are moving in this direction. Instead of buying computer systems to become more efficient in their own business, he says, they will increasingly be using IT to create services for their clients, in effect becoming part of the sector's supply chain.

Obvious examples are internet companies such as Amazon, E*Trade and eBay. But it is increasingly useful, says Mr Moschella, to think of more traditional firms such as banks, insurance companies and publishers as if they were a new kind of IT supplier: “All of the above are now in the business of systematically creating IT value for IT users, much as software and services companies have done in the past.” From the user's point of view, there is not much difference between an online banking site and Microsoft's Hotmail service.

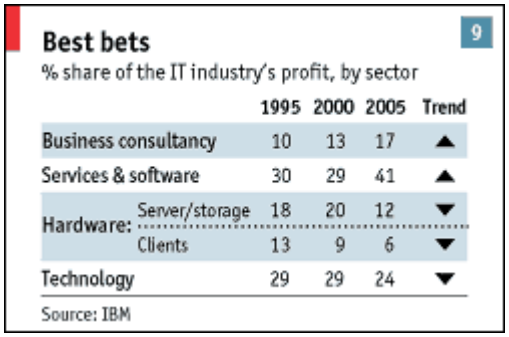
Being on top of the value chain, argues Mr Moschella, customers will increasingly be the industry's driving force. He urges them to band together and jointly develop new applications, platforms and standards in the same way that the financial industry has created credit cards and networks of ATMs. Such efforts could turn into “industry operating systems”, a term coined by Tom Berquist, an analyst with Smith Barney: huge IT hubs that will take over many of the functions common to firms in a particular sector.

All of this suggests that IT customers will capture more of the sector's rent. But even if things play out differently, the balance of power is likely to shift away from vendors and in favour of buyers. Having learnt the painful lessons of over-investment during the boom, they will no longer allow themselves to be locked into proprietary technology.

Nimbler than airlines

So will IT firms end up, in Mr Schmidt's worst-case scenario, “like today's airlines”, which always seem to be in or close to Chapter 11? Fortunately for shareholders, they probably won't, at least in the foreseeable future—for the simple reason that they will make active efforts to prevent such a calamity. In fact, vendors are already changing their business models, mostly by moving up the technology stack. Sun, which made a killing during the dotcom boom by selling high-end servers, is trying to become more of a software firm and a builder of power plants for computing utilities. And much of Microsoft's .Net effort is about software as a service.

Yet it is IBM that is betting most on the prediction that the IT industry will follow historic patterns of evolution. Big Blue expects profits to migrate to software and services (see chart 9), and is managing its product portfolio accordingly. For example, it has sold its hard-drive business and acquired the consulting arm of PricewaterhouseCoopers, an accountancy firm. Slowly but surely, IBM is morphing from a technology vendor with a strong IT-services arm into a business consulting firm that also sells software and hardware.



Best bets 9

% share of the IT industry's profit, by sector

		1995	2000	2005	Trend
Business consultancy		10	13	17	▲
Services & software		30	29	41	▲
Hardware:	Server/storage	18	20	12	▼
	Clients	13	9	6	▼
Technology		29	29	24	▼

Source: IBM

Bigger and better

The industry has also already begun to consolidate in response to the shifting balance of power. The merger of Compaq and HP looks much more prescient today than when it was announced in September 2001. Future corporate marriages will not necessarily be that huge, but there will be many of them. By 2004, predicts the Gartner Group, half of the vendors that were in business in 2000 will have disappeared. Oracle's Mr Ellison says there are at least 1,000 Silicon Valley companies that need to go bankrupt.

Such a mass exodus, again, would not be without historical precedent. Most industries have seen shake-outs when they grow up, says Steven Klepper, an economic historian at Carnegie Mellon University. In America's car industry, for instance, the number of producers peaked at 274 in 1909. By 1918, it had dropped to 121. By 1955, only seven were left.

The car industry is also instructive in that much of its production has been outsourced to suppliers. Similarly, predict George Gilbert and Rahul Sood, two software-industry analysts, software firms will now develop something they never had before: a supply chain. In a way, open-source is an early incarnation of this: a veritable army of volunteer programmers contribute patches to software such as Linux. In future, Messrs Gilbert and Sood predict, a large part of software development will be “outshored” to countries such as India and China, which are already generating much code (and not just the easy stuff). This will mean that big software vendors will become more like aggregators. At least one of them, SAP, is aiming at exactly that. It wants suppliers to develop applications, so-called xapps, and assemble them along with its own components into software suites.

But perhaps the best news for the industry is that there are still plenty of opportunities in the new world of IT. “If we go with the market, help our customers to realise the business value of IT, then we can be a good business,” says IBM's Mr Wladawsky-Berger. For a start, all that experimentation during the dotcom boom actually produced some useful results. Things tried during a technological bubble tend to make a comeback. The first transatlantic cable, for example, was a disaster, but it prompted others to try again.

Most business-to-business marketplaces failed dismally, because these start-ups thought technology would quickly overthrow existing power structures, explains Mr Moore. But these firms got one thing right: there are lots of assets trapped in inefficient supply chains. Established institutions are now pragmatically adopting these technologies, for instance in the form of private exchanges controlled by buyers.

And there still remain many more new things to try out, which is where IT arguably differs most from previous revolutions. Whether railways, cars or even electricity, all are relatively limited technologies compared with IT, which in time is likely to embrace the whole of business and society.

Currently, wireless technologies are all the rage, although again nobody knows how much money will be in it for vendors and carriers. Optimists hope that surfers will soon be able to roam around freely and

remain continuously connected to the internet. And small radio chips called RFID tags will make it possible to track everything and anything, promising to make supply chains much more efficient. But even a new killer application is unlikely to bring back the good old times. “After a crash, much of the glamour of the new technology is gone,” writes Brian Arthur, an economist at the Santa Fe Institute. The years after the British railway mania, for instance, were “years of build-out rather than novelty, years of confidence and steady growth, years of orderliness.”

This kind of “new normal”, in the words of Accenture, another IT consultancy, may be hard to swallow for a sector that has always prided itself on being different. But for its customers, a more mature IT industry is a very good thing: just as the best technology is invisible, the best IT industry is one that has completely melted into the mainstream. Thriving on exponentials was certainly fun. But even paradise can get boring after a while.

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Corporate ethics

Big oil's dirty secrets

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The ethics of the oil industry are coming under unprecedented scrutiny

EVEN as it celebrates soaring profits—thanks to higher prices during the war—and soaring share prices, now war is over, the oil industry faces a new danger largely of its own creation. It will surprise nobody to learn that oil and ethics mix about as well as oil and water. But, just as the tobacco industry and Wall Street gained a false sense of security because for years they got away with well-known practices of an ethically shady nature, only to pay a hefty price later, so too oil's hour of reckoning may be approaching. There are several reasons, including a high-profile bribery scandal; the growing political sensitivity of the oil industry; changing attitudes to corporate governance; and some potentially explosive lawsuits.

The bribery scandal, which seems certain to grow larger as more details emerge, concerns the battle to win oil contracts in Kazakhstan. During the 1990s, several big oil firms fought for the right to exploit the oil riches of the region, including Chevron Texaco, on whose board Condoleezza Rice served prior to joining the Bush administration. And, if prosecutors are to be believed, executives at some firms behaved over-zealously as this battle raged.

This week, Swiss investigators were reported to have added a bribery and money-laundering probe involving, among others, Crédit Agricole, a French bank, to continuing American investigations into alleged Caspian corruption. Last month, a grand jury in New York issued indictments against two Americans—James Giffen, an independent banker with close ties to the Kazakh president, Nursultan Nazarbayev, and Bryan Williams, a former executive of Mobil. Both deny wrongdoing. America's Justice Department is also looking into whether Mobil, now merged with Exxon, took part in a plan to pay $78m from American and European oil firms into Swiss bank accounts belonging to Mr Nazarbayev, among others. Exxon Mobil, the world's biggest oil firm, says it knows of no wrongdoing.

Oiling the wheels

This is already the largest investigation by American authorities into alleged bribery abroad. As it unfolds, it seems certain to provide plenty of colourful stories that will keep it in the spotlight. It involves well-known Russian businessmen and politicians, payments for speed boats and fur coats, and—if only because they too were involved in bidding for Kazakh contracts—other big oil firms besides Mobil, including firms with connections to senior Bush administration officials other than Miss Rice.

It may also provide the sternest test yet of America's Foreign Corrupt Practices Act (FCPA), which outlaws bribery. When the act was introduced in 1977, many American oil firms groused that the law handicapped them against foreign competitors when dealing in the undemocratic and unscrupulous parts of the world where oil is often found. That fear was not entirely groundless, as is clear from the current trial of former officials of France's Elf Aquitaine (now part of Total), where bribery seems to have been a core competency.

Some American oil-industry executives privately grouse that, if anybody is found guilty, it will be due to carelessness. The FCPA, they admit, can be skirted by careful use of “signature bonus” payments to middlemen brokering contracts and via “arm's-length” transactions involving law firms based, more often than not, in London. On the other hand, argues Scott Horton of Patterson Belknap, a New York law firm, the FCPA has prompted American oil firms, though generally opposed to transnational laws on corporate behaviour, to support efforts led by the OECD to impose an international ban on bribery.

The current scandal in the Caspian can only bolster such efforts to bring some transparency to this mucky business. But will it also lead to a greater questioning of some of the techniques used to get around the FCPA? Amy Jaffe, of Texas's Rice University, insists that the current investigation “is going to force every legal department at every major oil firm to ensure they have a clear picture of what their agents, advisers and everyone else in foreign countries are doing. The Giffen case will define what you can and can't do.”

Big oil is also facing legal troubles over its famed love of nature. This week, lawyers for aggrieved indigenous folk filed suit against Chevron Texaco in Ecuador. For a decade, legal activists have been trying to sue Texaco for dumping contaminated water in open ponds in that country's rain forest that, they claim, harmed both health and the environment. The firm denies wrongdoing, noting that there were no specific laws in Ecuador when it operated there that forbade its practices.

At first, the litigants pursued their claim in American courts, but a judge finally bounced the case back to Ecuador as the proper jurisdiction for the matter. That appeared to be a victory for the oil firm, but in order to have the trial moved south, Chevron Texaco had to agree to respect the ruling of the Ecuadorian court. If it does not, the American judge has retained the right to step into the matter once again. Joseph Kohn, a lawyer for the villagers, is already talking of $1 billion as his team's estimate for cleaning up the damage allegedly done by the firm—even before any compensation for suffering and so on.

But legal attacks on alleged human rights abuses committed overseas may prove to be the most nettlesome of all for the oil industry. Consider the sort of public denial prompted by a lawsuit filed last month against an American oil firm: “Occidental has not and does not provide lethal aid to Colombia's armed forces.” Even if the firm does indeed prove not to have provided “lethal aid,” it faces a high-profile trial exposing its relationship with a regime with an, ahem, uneven record on human rights. Similarly, Exxon is being accused of complicity in abuses committed by the Indonesian military in Aceh, and Unocal stands accused of benefiting from forced labour deployed by the military government in Myanmar. Both firms have consistently denied any wrongdoing.

These cases are tests of America's Alien Tort Claims Act (ATCA). As the law dates back to 1789, its critics note that it does not deal with the precise circumstances of today's cases: it was probably intended to give foreigners a legal forum when in America, rather than offer a domestic remedy for American misdeeds abroad. Oil industry lobbyists have been pushing Congress to repeal the ATCA. Last year, the Bush administration took the unusual step of intervening in a lawsuit brought by the International Labour Rights Fund (ILRF) against Exxon, arguing that applying the ATCA in this case might hinder America's efforts to fight terrorism.

Even so, points out the ILRF's Terry Collingsworth, starting in 1980, this statute has indeed been applied in human-rights cases where foreign states or victims have been involved. Now, particularly with two separate cases related to Myanmar in American courts, it may end up applying to corporations that are judged to be “knowingly complicit” in abuses.

Could this be enough to transform an industry that is famously shameless, not least in America? Maybe. A few big legal losses, lots of bad headlines, and an impending Presidential election with an oil man on the ballot might work wonders.

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Iraq's oil

Back to work

May 8th 2003 | NEW YORK
From The Economist print edition

Finally, a new management team

AFP

Not an American imperialist

THE rough outline of a management team for Iraq's oil—albeit a controversial one—is now becoming clear. For while the advisory board being developed for the sector includes some Iraqis, it is clear that America plans to run the show for a good while yet.

Heading the advisory board is Philip Carroll, a former executive of Royal Dutch/Shell. Number two is Fadhil Othman, a former planner at the Iraqi oil ministry. The board will advise—or perhaps supervise—a new chief executive of the oil sector, Thamer al-Ghadban, a veteran Iraqi oil bureaucrat.

The new management's likely policies remain unclear, not least pending the release of a white paper on the future of Iraq's oil industry by America's State Department. Prepared by a group of Iraqi exiles and outside experts, this is expected to address both foreign investment and privatisation.

But the first challenge is to safeguard employees and petrol stations—and to ensure that Iraqis have enough petrol and power. The electricity system is creaking. The country's oil output is less than a tenth of its pre-war level of roughly 2.5m barrels per day (bpd); Iraqis normally consume about 500,000 bpd. So the country's oil managers and their military helpers desperately need to revive production. Meanwhile, they are rushing in imports of liquefied petroleum gas and gasoline from nearby countries to make up the shortfall.

Further ahead, say some analysts, it would be relatively easy to privatise certain parts of the industry, such as refineries. But if advisers put in place by America decide that the country's upstream assets must immediately be privatised, they are likely to meet strong domestic resistance.

They might also face opposition from abroad, especially if Britain and America appear to be favoured over other countries. Russia has talked of defending the contracts it holds from the Saddam era.

Many Iraqis are already worried about a possible rush to privatisation. This week, Radwan al-Saadi, head of the oil ministry's finance department, told the Energy Intelligence Group, an industry publisher, that “privatisation will be discussed at the national level once an internationally recognised government is in place. Failing that, doing it by force is nothing but piracy.”

Much depends on what the UN decides to do about its sanctions and oil-for-food programme, a political process under way at last. What “vital role” will the UN get to play in Iraqi oil? And what price will France and Russia extract for letting Iraq export its oil again?

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American health care

Is IT the cure?

May 8th 2003 | CHICAGO
From The Economist print edition

At last, the health-care business is embracing new technology

THE timing was almost perfect. As severe acute respiratory syndrome (SARS) cut a widening swathe around the globe, the national Centres for Disease Control (CDC), America's leading public-health organisation, inaugurated a state-of-the-art emergency operations facility last month to respond to just such crises. With dozens of computers, a central command station, high-frequency radios and disease-mapping systems—much of it donated by firms such as Motorola and Hewlett-Packard—the 7,000 square-foot centre brings the CDC closer to its goal of faster information-sharing about health threats.

Yet, overall, America's health system, public and private, lags other parts of the economy when it comes to using IT. Public-health officials often rely on pencils and telephones to gather data on outbreaks. And Americans who run their lives with their Palm Pilot may feel they have stepped back in time when they don a patient's gown at the local hospital, where besides long waits and harried nurses, they must contend with the risk of lost records in manila folders and potential overdose caused by a doctor's bad handwriting.

Gartner Group, a consultancy, says that America's hospitals spent less than 3% of gross revenue on IT capital and operating budgets last year, compared with the 10% typical among hardware and software firms and over 7% in financial services. Hospitals are tough to automate for several reasons: transient workers, clients who often move, fierce competition for funds and independent-minded physicians, who are often not employees of the hospitals where they practise.

Now, health-care firms are taking more interest in IT. The spurs include consumer pressure, a shortage of nurses and technicians, the threat of having to deal with bioterrorism and pressure for pay-for-performance from insurers and big employers, whose health-insurance costs are soaring.

Gartner predicts that the average American hospital's operating budget for IT will grow at 10-15% a year in 2003-05. Financial incentives will be crucial to boost spending. Some health-care buyers are rewarding hospitals for persuading doctors to enter orders for drugs and treatment on computers. That reduces medical errors—and saves lives: one study, a few years ago, suggested that such errors cost 98,000 lives a year. Firms including Xerox, IBM and PepsiCo pay a bonus to hospitals where doctors use this approach.

At the IT-pioneering University of Illinois at Chicago (UIC) Medical Centre, doctors and nurses are now able to gain access to electronic medical records and charts, and directly enter medication orders, at thousands of computers throughout the hospital, outpatient centre and eight satellite clinics. They use laptops, wheel-around units and wireless devices. “We wanted to create something that was really cool, a magnet,” says Joy Keeler, UIC's technology officer.

A growing number of firms claim to offer high-tech ways to boost efficiency and data-sharing in healthcare. Siemens Medical Systems, best known in hospitals for its medical imaging machines, is now the market leader in clinical and administrative hospital information systems. It offers all kinds of hospital software and is a leading data centre, processing more than 140m health-data transactions daily (it claims to capture registration data for 25% of America's hospital emergency-room visits). In five years, says Klaus Kleinfeld, the head of Siemens Medical's American parent, at least 40% of the medical unit's revenue will come from IT. That would be double what it is today (sales hit $4.1 billion last year, up by 14% from a year earlier). “Flash Gordon meets Dr Kildare” is how Mr Kleinfeld describes his vision of a fully digital hospital. Perhaps one day, like Flash, it will save every one of us.

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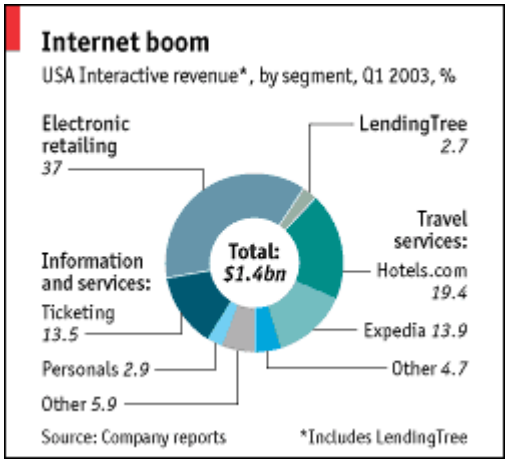
Online commerce

Ugly duckling

May 8th 2003 | NEW YORK
From The Economist print edition

Barry Diller finds profits in e-commerce

Get article background



BARRY DILLER wears the fine suits that still mark men of power in old media, where he has spent most of his 40-year career. Yet in his latest incarnation, as boss of USA Interactive, Mr Diller can plausibly claim a seat at the very top table of American internet moguls, alongside visionary types such as Jeff Bezos, the boss of Amazon. Unlike the visionaries, Mr Diller cut a string of deals to build his empire, which spans travel (Expedia, Hotels.com), tickets (Ticketmaster) and dating (Match.com).

On May 5th, Mr Diller added finance to the mix, paying over $700m for LendingTree, a marketplace where credit firms compete to lend. That is a lot for a firm whose main business, mortgage refinancing, may have seen its best days. Yet USA Interactive's share price barely moved.

Romance is blossoming between Mr Diller and his shareholders. Wall Street's new favourite is a sort of anti-internet guru—a short-tempered, hard-nosed businessman with an eye for profits. “Barry Diller has no vision for the future of the internet,” proclaimed *Wired* magazine recently, no doubt delighting Mr Diller's publicity machine with its discovery of his “opportunistic” instincts.

Mr Diller has made some canny bets: Hotels.com, Match.com, Expedia and Ticketmaster each claims to be profitable. Mr Diller has avoided online businesses, like Amazon's, whose promise to ship goods to customers involves costly real-world things such as warehouses and trucks. (But he does still own the Home Shopping Network, a cable-TV channel which sells and delivers schlock to couch potatoes). Like eBay, USA Interactive is “asset light”, running marketplaces that cleverly strip customers (travellers, borrowers) from vendors (hotels, airlines, car-rental firms, lenders). This leaves the customer-bereft victims with the costly, low-margin work of fulfilling the flow of orders that USA Interactive now controls. Banks such as Citibank, boasts LendingTree's boss, Doug Lebda, have whole departments to process loans that his firm originates.

The real promise of USA Interactive is to make the most of these hijacked customers (40m so far, it claims) by cross-selling services and building brand loyalty. Yet buying an airline ticket from Expedia does not yet prompt offers to shop for a budget hotel room at Hotels.com, still less a companion, from Match.com, with whom to share the bed. Some of the creatures in USA Interactive's stable of brands, meanwhile, compete directly with each other: Expedia's successful hotel business is a rival to Hotels.com, for instance.

Such flaws are not so surprising. Mr Diller has been busy escaping from his old-media past. It was only in March that he finally resigned from his other job, as boss of Vivendi Universal's American entertainment businesses. (USA Interactive was always his “day job”, claims Mr Diller.) He may yet sell the Home Shopping Network. Consolidating the ownership of USA Interactive's internet assets has also taken skill and patience. “We're just at the beginning of this,” says Mr Diller. Now Wall Street's latest swan must continue to make progress, or, unlike in the fairy tale, he could easily find himself turned back into a dowdy duckling, fine suits notwithstanding.

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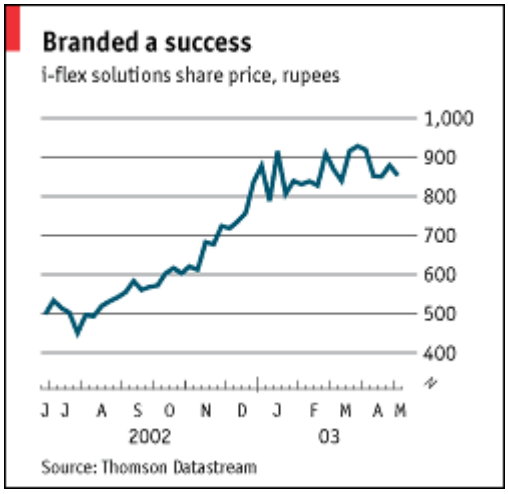
Indian software

Techno-coolies no more

May 8th 2003 | BANGALORE AND DELHI
From The Economist print edition

Does India need its own software brands?



IT DOES not have the high-street resonance of a Nike, a Pepsi or a Windows. In its unglamorous but lucrative niche in the bank back office, however, FLEXCUBE is the brand of choice. According to rankings published in March by International Banking Systems, a trade journal, it is in fact the world's best-selling banking-software product. Its owner, i-flex solutions of Bangalore, is one of India's software success stories. Some even argue that it points the way forward for the whole industry: let it emerge from the shadows where Indian techno-coolies beaver away writing code that is sold in an American or European wrapper. The moment has come, runs this argument, for “made in India” software products to enjoy their day in the sun.

The notion has an obvious appeal to an industry that feels under threat on two fronts: from cost-cutting competitors elsewhere, eating away at its margins; and from a perceived protectionist backlash in America and Europe against the outsourcing of IT jobs to India. The seriousness of the bout of nerves afflicting the industry has been in evidence on the stockmarket. After Infosys and Wipro, two of the biggest Indian software firms, announced disappointing results last month—at least relative to some extremely bullish expectations—the entire Mumbai market suffered a nasty attack of the wobbles.

As for the rising tide of protectionism, some commentary in the Indian press saw i-flex itself as a victim, when the boss of its Dutch operation was arrested in London in March for alleged visa irregularities in Holland. This followed the harassment of some Indian IT workers in Malaysia, and the application of tighter visa rules in a number of countries.

This may well be the result both of over-reactions to the September 11th terrorist attacks and of unfortunate coincidence, rather than a global conspiracy against Indian IT professionals. But many agree that IT exports would be more secure if they relied less on outsourcing and were “products”, where the Indian seller owns the intellectual property, not just the brainpower-for-hire. Mixing his metaphors wildly, Rajesh Hukku, the founder and chairman of i-flex, argues that Indian firms otherwise risk being doomed forever to providing “the cheap labour at the bottom of the food chain”.

The success achieved by i-flex, however, may be difficult to replicate. It is thriving in a uniquely large IT market—financial services—partly because of its own unique heritage. It evolved out of Citicorp Overseas Software, a software-development subsidiary of the global financial superpower, which gave it a strong, worldwide launch-pad.

Just as i-flex was set up with capital from Citi, in 1992, its first offering was also a legacy from the parent: “Microbanker”, a “bank in a briefcase”. In 1998 it released FLEXCUBE, a more sophisticated back-office and transaction-processing system, which now has more than 120 customers in over 50 countries. In some, such as Kenya, where four-fifths of banks use it, bank-job advertisements demand familiarity with FLEXCUBE. But its client list also stretches to investment banks and the International Monetary Fund.

Although i-flex is much the biggest Indian “product” company, there are others. Its closest rivals are divisions of the big software-services firms. Infosys, for example, has its own banking product, Finacle. Other Indian firms offer packaged Enterprise Resource Planning and Customer Relationship Management

software. But none is in i-flex's league. Some 65% of its sales (of about $100m in the final three quarters of 2002) are in the form of products—Microbanker, FLEXCUBE and Reveleus, a “business-information tool” for financial institutions.

Products, however, make up only a tiny fraction of overall overseas sales of Indian software and IT services. Last year, Nasscom, the Indian industry's lobby group, estimated that India captured just 0.2% of a global market of $180 billion for software products. It expects that to increase, but recognises the obstacles. The product business depends on heavy investment in sales, marketing and branding.

Those are areas where Indian firms have tended to be frugal, often for the simple reason that they have not needed to spend much. That may remain the biggest obstacle to the rapid growth of a products business: the continued potential, despite the current worries, of services exports. With the American economy still in the doldrums, pressures to cut costs and outsource remain intense, and, as yet, the fears of a protectionist backlash seem overblown. Indeed, almost all the big makers of branded software—Microsoft, Oracle, Adobe, SAP, Sun and so on—have a presence in India, employing thousands of Indian IT workers of their own or on contract from Indian IT-services firms. For many Indian firms, a products business would be a tasty addition to their regular diet. But only if it can be enjoyed without eating their clients' lunches.

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Airlines

United vultures

May 8th 2003
From The Economist print edition

Who gains if United should die?

UNCERTAINTY surrounding America's airline industry is making strategic decision-taking for other airlines rather like trying to land an aircraft in the mid-west tornado belt this week. While Glenn Tilton, boss of United Airlines, prepares to unveil details of his latest recovery strategy, some international carriers still doubt that it will work. Worries about United sliding from Chapter 11 insolvency (protection from creditors pending a financial re-structuring) into Chapter 7 (liquidation) are delaying a deal that could re-shape the international industry. The board of KLM, which met this week to approve another grim set of results—an annual net loss of *euro*416m ($412m)—delayed a decision on which international alliance to join because of the potential upheaval of a United collapse.

Were United to fly no more, there would be big consequences for the airline alliances, partnerships formed to skirt rules blocking international mergers. The biggest is Star, built around Lufthansa, United and All Nippon Airways. If it were to lose United, its biggest member, there would be such a scramble to replace the American partner that the two other big alliances (SkyTeam and oneworld) could be torn apart as Star woos Delta Air Lines and American Airlines, their American anchors.

At first sight, KLM would be merely a bystander. For nearly ten years, its partner has been Northwest Airlines, with which it has a joint venture on transatlantic routes: they pool customers, revenues, and so on. But Northwest has won regulatory approval to ally with Delta Air Lines and Continental Airlines to market jointly domestic flights (they will share flight codes on schedules). This would make it logical for Northwest and KLM to throw in their lot with the huge SkyTeam global alliance, led by Delta and Air France.

In fact, KLM is debating whether instead to accept an offer from oneworld, an alliance built around British Airways, American Airlines and Cathay Pacific. SkyTeam makes sense geographically, linking the nearby Dutch, French and Italian markets (Alitalia is part of SkyTeam). But the appeal of oneworld includes the allure of unrequited passion.

The BA-KLM link (they have flirted for 15 years) would be logical in terms of market segmentation rather than geography. It would join the British carrier's lucrative, point-to-point premium business traffic to KLM's ability to handle transfer passengers at its Amsterdam Schiphol hub, which has lots of capacity. Locked in at Heathrow, BA needs a continental hub to keep growing. But nobody wants to decide until United's fate is known.

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Corporate tax and accounting

Many happy returns?

May 8th 2003 | NEW YORK
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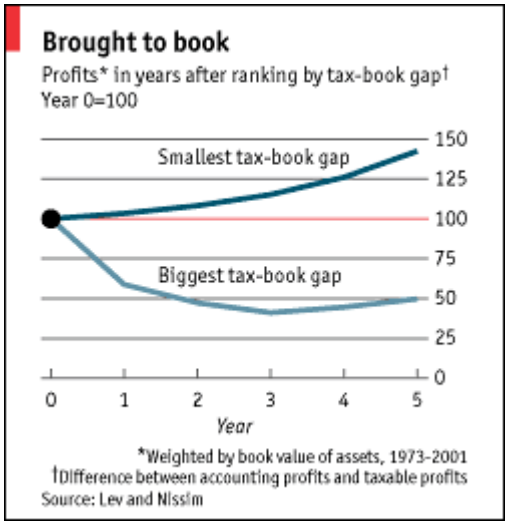
Why a low corporate tax bill is often not the good news it seems to be



WHAT is the next target in the campaign to clean up American capitalism? Perhaps tax trickery. Already, a Senate sub-committee and the Internal Revenue Service (IRS) are busily pursuing separate investigations into questionable tax structures. This week, there was talk of cutting taxes on profits earned abroad to 5.25% from 35%, for this year only, to tempt firms to repatriate money now in offshore tax havens and shelters.

This comes hot on the heels of a Congressional report on the Enron scandal, released in February. This devoted 2,700 pages to how the firm manipulated the so-called “tax-book” gap—the divergence between the profits that American firms report to the taxman and the accounting (“book”) profits disclosed to the investing public—to inflate its reported profits while minimising its tax bill. Thanks not least to its use of tax shelters, in 1996-99 Enron reported to the taxman that it earned no taxable income even as it told Wall Street that it had made $2.3 billion in book profits.

Step back from the scandal, and two things stand out. First, according to the report, Enron's accounting gymnastics were not necessarily illegal. Rather, they cleverly exploited inconsistencies in the different rules for tax and book accounting. Second, it is not just Enron. The tax-book gap has widened alarmingly across corporate America, especially since the late 1990s.

Some of the tax-book gap is readily explained by the treatment of depreciation, employee share options (which count against profits for tax but not for accounting purposes) and foreign income. But whereas these used to explain most of the gap, by 1998 they represented less than half of it, according to a recent study by Mihir Desai of Harvard Business School. The source of the rest of the gap was hard to explain, he charitably concludes.

Perhaps the gap is due to the growing use of Enron-style rule-gaming, which creates (briefly) healthy accounting numbers but cannot get past the more prudent tax rules. If so, a growing tax-book gap may herald accounting troubles to come.

Baruch Lev, of New York University's Stern School, and Doron Nissim, of Columbia Business School, analysed the tax-book gap of over 3,000 publicly traded American firms during 1973-2001. As the chart shows, they found that the 20% of firms with the smallest gap between tax and book profits showed strong average accounting profit growth over the subsequent five years. But the 20% of firms with the biggest tax-book gaps tended to see their profits deteriorate dramatically.

This finding is admittedly fairly rough and ready. Since, amazingly, American firms are not required to disclose how much tax they have paid during any given accounting year, the two academics had to estimate taxable profits from the meagre morsels of data included in company annual reports. The information disclosed in accounts is notoriously long on numbers but short on substance. “Current tax expense”, for example, is based on book accounting rules and so is uncorrelated with a firm's tax bill. Whereas many firms disclose a figure for cash paid to the taxman, they are not required to provide a breakdown for jurisdiction (foreign versus federal or state taxes) and do not specify the time period for which this tax was owed.

Open the books

At certain points in the past, disclosure of tax-return information was much fuller. President Taft, under whom the first corporate tax was levied in 1909, saw publication of tax returns as a way to discourage undesirable business conduct. Later presidents disagreed, but this view again prevailed during the Great Depression, when Congress passed a law making public selected bits of corporate tax returns—such as a firm's net income and tax liability—in so-called “pink slips”. Intense lobbying by big business succeeded in repealing this law within a year. Since then, the government has not mandated any similar corporate tax disclosure. It was not until 1976, however, that tax-return information became wholly confidential—following allegations that President Nixon had used tax-return information against his opponents.

Investors would surely benefit from much fuller disclosure of a firm's tax return. But how best to disclose? The most radical solution—and the least likely—is to move closer to “tax-book conformity”, with a single set of accounts for both the taxman and investors. Dual accounting, so the argument goes, is unduly complicated and can distort economic activity. For instance, employee share options became a popular form of compensation at least in part because they lowered taxable profits but left accounting profits intact.

One drawback of this solution is that Congress loves tinkering with the tax code in an attempt to change corporate behaviour, and is unlikely to give that up. Besides, the goals of tax and financial reporting are very different. Tax accounts are meant to provide authorities with a predictable, enforceable tax base. Financial reports are meant to capture the economic value of a firm's operations, and so contain myriad estimates and approximations. Resolving these two goals into one set of books is impossibly tricky. When it was tried, such as (until recently) in Germany, the needs of the taxman have tended to come before those of investors.

A second option is to publish corporate tax returns in full. Industry advocates, however, worry that tax disclosure would let competitors root out business secrets, and would lobby hard to stop it.

The best approach may be to require firms to publish a souped-up version of Schedule M-1, a table (rather superficially) reconciling taxable and accounting profits, that they already submit to the taxman. In a recent paper, George Plesko, of the Sloan School of Management, and Lillian Mills, of the University of Arizona, propose how that might be done in a way that gives investors a mechanism for linking a firm's taxable profits to its financial numbers. One change would be to specify explicitly what starting point should be used for tax-book reconciliation. Now, corporate taxpayers are required to use their “reported profit”—but can pick from global income, American income, or something between, and the choice results in wide swings in the tax-book gap. Mr Plesko and Ms Mills argue that the proper starting point is worldwide consolidated book profit.

In Congress these days, there is much implausible talk of fundamentally overhauling the corporate tax code—a process that history suggests would inevitably fall foul of political tinkering, if it were ever seriously attempted. But, for all this post-Enron bluster, it makes far more sense simply to make firms publish sufficient information for investors to tell if a low tax bill is in their interest or against it. What is more, it would be far easier to implement.

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Face value

Giving people what they want

May 8th 2003
From The Economist print edition

Companies are still failing to put their customers first, says Shoshana Zuboff

YOU know the feeling all too well. Some widget in your home computer expires. Result: it no longer talks to your printer. You telephone the PC maker's helpdesk, only to enter a maze of “press nine for immediate assistance” and “your call is important to us”. After 15 minutes of nasty music, a voice tells you to call a different number: that particular widget is their responsibility, not ours. Eventually, a new widget is said to have been shipped to you. Two weeks and many phone calls later, it has not arrived. You throw the PC away and start again.

Life is full of experiences such as these, curiously removed from the silvery promises of television advertisements and the salesman behind the counter. They are the core of a new book, “The Support Economy” (Allen Lane), by Shoshana Zuboff, a Harvard Business School professor, and her husband, James Maxmin, a former boss of several British firms. A chasm now separates individuals and firms, she says, and that gap is the next big business opportunity. People yearn for support to help them through life's complexities and those moments when the promise of reliability turns sour. Providing that “support economy” is, as the book's subtitle puts it, “the next episode of capitalism”.

The book has plenty of tales of how firms fail to give consumers the service they have promised: “People have come to accept that their consumption experiences have been largely adversarial.” All the talk is of nurturing customer relationships; the reality is the frantic woman dashing from one airline's gate to another, trying to get on to a flight home and finding one cancellation after another and sullen, unhelpful staff. When firms cut costs, they often do so in ways that upset consumers: they put pressure on frontline staff who handle complaints, shaving seconds off the time each call-centre operative is allowed to spend on a pacifying call; or they squeeze up prices in ways that turn what looked like a good deal into a lousy one, the moment something goes awry; or they use customers' data to pretend to an intimacy and understanding of their needs that does not really exist.

Miss Zuboff's grumpiness at corporate failure is not the tone of her previous book, on which her reputation is built. “In the Age of the Smart Machine”, published in 1988, discussed how information technology might be used to organise work in ways that could empower employees. Computers would allow clerical staff to make more decisions, help top managers to improve efficiency and give blue-collar workers a better understanding of industrial operations.

It was, she now says, “written with an underlying belief in the progressive corporation”. But it was followed by what she calls “an intellectual mid-life crisis”. The progressive corporation was a myth—or rather, might perfectly well turn out to be Enron. She and Mr Maxmin, a perfect marriage of business school professor and executive, bat ideas back and forward at their home in Maine all the time. One night, clearing up the kitchen, they had an epiphany, and the concept of the support economy was born.

Promises, promises

The difficulty begins with companies promising customers support that they cannot deliver. As Miss Zuboff says, electronic networks mean that firms now know more about their customers than ever before. So they believe that they can treat customers as individuals, even if, partly for cost reasons, they continue to mass produce for them. Meanwhile, customers' expectations have risen: a legacy, not least, of the internet bubble. They want choice, reliability and to be looked after as individuals. This is, after all, what the advertising promises. All those pledges to remember, next time you check into a hotel, whether you like a soft pillow or a hard one: they have an impact.

Every manufacturer these days wants to offer service as a distinguishing characteristic; and every service business wants to build relationships with its customers, because it knows that retaining existing customers costs far less than recruiting new ones. But providing services turns out to be expensive and complex. Outsourcing services, whether a bank outsources its credit-card business or a hotel its reservations, is harder to manage than outsourcing the manufacture of chips or tyres. Gaps appear through which customers slip when something goes wrong. Besides, the prices of many goods have been falling; but the cost of services, including the helpdesk, continue to rise. And the more reliable goods become, the fewer customers need help—and the more redundant (and expensive) the helpdesk seems to be.

When it comes to a cure, Miss Zuboff and Mr Maxmin see the answer partly in the structure of corporations, which they regard as too narcissistic, too stuck in old concepts of mass production, even too male-dominated (real men, it seems, won't let the customer come first). They want a new kind of organisation that supports customers through “distributed capitalism”—which seems to mean empowering the workers that “Smart Machine” also put its trust in. Their recipes are sometimes a little, um, unclear: “The centrality of collaborative co-ordination can evolve in proportion to the devolution of institutionalised routines.”

But does the solution really lie in new corporate structures and new businesses, designed to support customers in trouble with their airline or computer company? That depends on whether consumers are willing to pay for support. If they are not—which many firms fear—support will remain a cost with no matching benefit, at constant risk of being squeezed.

This point is crucial. Yet the word “profit” is not even indexed in the book, which is so vague about the role of profit in the support economy that it has been championed by critics of shareholder-value driven capitalism, such as Will Hutton, a leftish British commentator. *The Economist* will make this bet: if the customer-centric support economy does come to be, the main reason will have been the unrestrained pursuit of profit.

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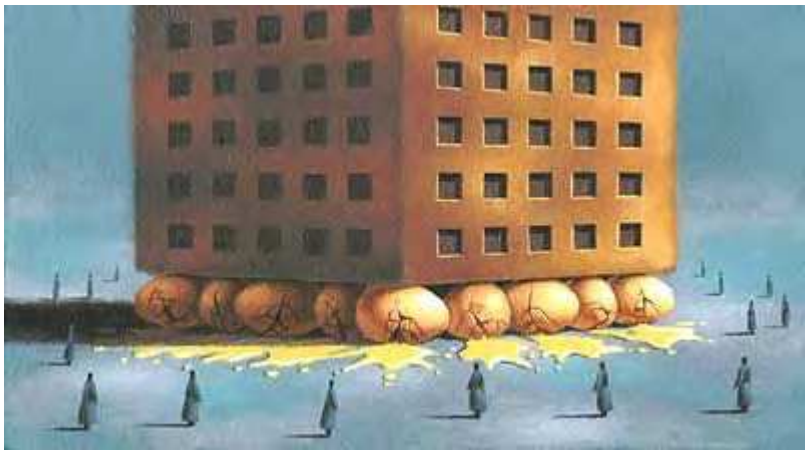
Corporate pensions

Nest eggs without the yolk

May 8th 2003
From The Economist print edition



Can employers be trusted to provide for our old age?

POLICYMAKERS in America and Britain used to be rather smug about their pension systems. They had shifted much of the burden of providing for people's retirement off the state and on to the private sector, they crowed, while in most countries in continental Europe private pensions were still embryonic. The future burden on the exchequers of these countries from increasing longevity and shrinking birth rates made for headlines about a “pensions time bomb” ticking away while powerful unions blocked attempts at reform.

Nowadays there is less complacency. Over the past year or so, in both Britain and America, there has been growing alarm about the state of companies' pension funds. The private sector's back was not as broad as policymakers thought. Many of the schemes are now deeply in deficit, to the consternation of prospective pensioners, investors and politicians.

Further dismay has greeted revelations of the extent to which top corporate executives have been able to shelter their own pensions from the effects of this fall in value. Not untypical were the special pension arrangements of the top executives at American Airlines—including Donald Carty, its erstwhile boss. While the airline's bosses secretly protected their own pensions against the risk of bankruptcy (with a multi-million-dollar dollop of extra funding), employees were being asked to accept hefty cuts in pay and benefits in order to save the firm from going bust. Likewise in Britain, it was recently revealed that Sir Geoff Mulcahy, who resigned last year from the top job at Kingfisher, a poorly performing retailer, left with a nest egg of £15.2m ($24.5m), which will pay him an annual pension of £790,000.

Deficit days

In America, many companies now run large corporate-pension deficits (the amount by which the value of the schemes' assets falls short of the current value of the pensions they are pledged to pay in the future). These deficits arise entirely from defined-benefit pension plans, which guarantee employees a pension related to their final salaries. Defined-contribution schemes—the other main type of pension—make no promises about ultimate benefits, merely contracting to pay a certain amount regularly into a fund.

According to estimates by the Pension Benefit Guaranty Corporation (PBGC), a quasi-governmental agency that insures the basic benefits of 44m Americans with pensions provided by about 32,500 private

defined-benefit plans, corporate-pension deficits have swollen to some $300 billion. A recent study by Greenwich Associates, an investment-research firm, claims that the assets of corporate pension schemes have lost $500 billion in value in the past two years.

In Britain, corporate pension schemes are also in trouble. Morgan Stanley, an investment bank, estimates that the aggregate deficit of the defined-benefit pension schemes of FTSE 100 companies grew from £200m at the end of 2001 to £65 billion at the end of 2002. UBS Warburg, another investment bank, says that only four of the 100 companies retain a net surplus on their pension funds; 22 firms have pre-tax deficits in excess of £1 billion. The pre-tax deficits of seven firms—including blue-bloods such as Rolls Royce and British Airways—amount to more than half of their market capitalisation.

Not all those with underfunded schemes are American or British. Last June, Siemens, a German technology firm whose employees are almost all on defined-benefit schemes (a rarity in Germany), had to admit that it had a pensions deficit of more than *euro*5 billion ($4.8 billion) under American accounting rules—which the company follows because it is quoted on the New York Stock Exchange.

If equity markets do not recover quickly and substantially, the deficits will widen even further this year. Of course, if the markets bounce back, the problem will disappear, at least for now. Most of the funds' liabilities lie some way in the future.

The main reason for the recent shift from surplus to deficit is the prolonged bear market that began in March 2000. The pension funds of American and British companies all invest heavily in equities. American funds have, on average, 60% of their assets in shares. In Britain, the figure is even higher, with as much as 80% of funds' assets in equities, about two-thirds of that invested in the British market.

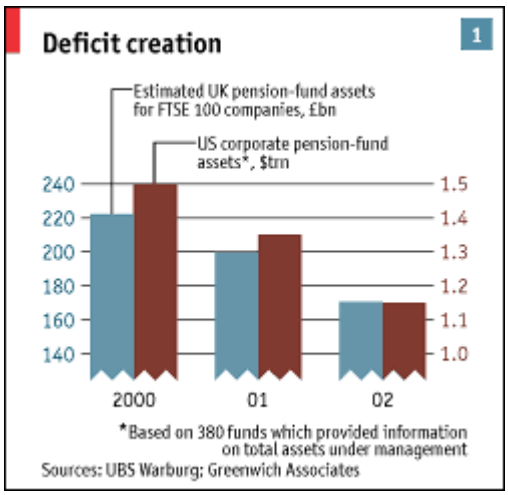
In the bull market of the late 1990s, this worked in the funds' favour, and many of them accumulated huge surpluses. The tax system forced many companies—British Airways, for one—to take holidays from contributing to their fund; and some—such as Shell, Unilever and Philips—even took money out of them.

Transparently underfunded

America's accounting-standards body, the Financial Accounting Standards Board (FASB), said earlier this year that it wants to improve accounting for employee pension plans. It aims to publish a standard on the subject next year.

In Britain, a new accounting standard, FRS17, has already made the deficits in companies' pension funds glaringly obvious. The standard, which compels companies to value their pension assets at current market prices, is not yet fully implemented. But since June 2001 British companies have had to disclose their FRS17 numbers in notes to their accounts. Before that, says Alan Rubenstein, head of the pensions group at Morgan Stanley, “with negligible transparency, pension funds were assumed to be in surplus.”

Highly unpopular with most companies (which prefer the opacity of the old system), FRS17 demands that a pension fund's short-term deficits be deducted immediately from profits, or added back if the fund is in surplus.



Under America's Employee Retirement Income Security Act (ERISA) of 1974, a fund is considered to be underfunded if the market value of a plan's assets is less than 90% of the plan's current liabilities. Deficits have to be made good, typically over a five-year period. General Motors, for example, has announced that contributions to its underfunded pension scheme will reduce its earnings by 26% this year.

Britain has a statutory annual test that evaluates the adequacy of a scheme's assets to meet its obligations. The test stipulates that a “seriously” underfunded scheme rectify its shortfall within three years. Schemes that are underfunded, but not seriously so, have to be brought in line within ten years. The British government is currently considering legislation that would modify or even abolish the test, but it is still uncertain when new rules would come into force.

Over the past couple of years in America, pension liabilities have become a key element in corporate insolvencies and resurrection from Chapter 11 bankruptcy. US Airways, for instance, America's seventh largest airline, was able to emerge from bankruptcy protection a few weeks ago only after shedding its pension obligations. The pension plan for its pilots is, the company says, underfunded to the tune of $2.5 billion. After much coming and going, the PBGC took over as trustee of the airline's pension plan on April 1st.

To appease its angry pilots, the company will set up a secondary plan that will cover some of the shortfall between what the pilots receive now and what they will get under the PBGC's basic regime. It is unlikely to assuage their anger with Stephen Wolf, who ran US Airways until a few months before it went into Chapter 11 in August last year. He was able to walk away with a one-off pension payment of $15m after a mere six years in the job.

US Airways may not be the last of the big American airlines to have trouble with its pension promises. Fitch, a credit-rating agency, estimates that the deficit in the funds of America's eight biggest airlines is more than $18 billion. As recently as 1999, they had a surplus of $1 billion.

Debt without a doubt

The shortfall in America's corporate pension schemes has been such that even the PBGC is broke. This was hard to imagine 16 months ago when the agency sat on a comfortable surplus of $7.7 billion. But it is now in deficit to the tune of $5.4 billion. As it is financed by insurance premiums from corporations, it will probably have to raise prices across the board in order to refill its coffers. This will meet stiff resistance from corporate America, but the alternative (federal funding) will be resisted too. “Why should taxpayers foot the bill for something that was supposed to be self-financing?” asks Zvi Bodie, an expert in pension finance at Boston University.

The new spotlight on the deficits in companies' pension funds is having an effect on their share price. Credit-rating agencies and investment analysts are giving them the thumbs-down, and investors are starting to vote with their feet. At the end of last year, Morgan Stanley put together a list of British companies that are most at risk from underfunded pensions. Some prestigious names were on it. Sainsbury's, a supermarket chain, for instance, is estimated to have pension-fund assets worth only 65% of its pension liabilities.

UBS Warburg is advising investors to part with shares in companies that carry too much pension risk. On April 3rd, it lowered (to “sell”) its recommendation on six media and technology companies because of worries over their pension liabilities. British Telecommunications (BT) is singled out by the investment bank because of its post-tax pensions deficit. Standing at £1.3 billion at the end of March 2002, UBS estimates that it had increased to £6.5 billion by the beginning of 2003.

Though they claim that pension liabilities have always been considered when they make a judgment about a company's financial strength, Standard & Poor's (S&P), Moody's, Fitch and other ratings agencies have started to look at them much more closely. S&P issued a report in March that attempted to clarify its approach, pointedly stating that nowadays the agency treats unfunded pension liabilities like debt. (In the past, it did not take pension liabilities into account in its calculation of a company's net debt.)

Moody's and Fitch recently came out with similar statements about their methodology. “It absolutely is debt,” insists Boston University's Mr Bodie. Sabine Mahnert, a pensions expert with Morgan Stanley, thinks pension liabilities are slightly softer than other forms of debt, but she agrees that debt they undoubtedly are.

Companies with pension plans that are unfunded, as many are in continental Europe, find such views hard to take. Their plans, they say, are financed on a “pay-as-you-go” basis, and do not need funding. Earlier this year, ThyssenKrupp, a German steelmaker, clashed with S&P over this debate. On February 21st, the rating agency cut ThyssenKrupp's rating by two notches (to junk status) because of its unfunded liabilities. At the end of September 2002, these amounted to *euro*7.1 billion. At the time,

Thyssen was one of 12 European companies under review by S&P because of the burden of their pensions.

The company's executives denounced the downgrade as “incomprehensible”, and government officials took their side, arguing for the establishment of a new European ratings agency. Joachim Poss, spokesman for the Social Democrats, Germany's ruling party, claimed that S&P and Moody's, both of them American, do not understand German business culture.

Continental drift

For the most part, companies in Germany (and France and Italy) face a rather different sort of pensions crisis. Governments there have promised for years to privatise part of the state system, but little has happened to date. Public-pension spending is gobbling up between 12% and 14% of French, German and Italian GDP. In Germany, the goal is for the state to provide 70% of the final net salary of an employee who has worked for 45 years. (This is being reduced to 67% over the next decade.) Corporate pensions from companies such as Siemens and ThyssenKrupp supplement this system. Unlike America and Britain, Germany has few regulatory or tax incentives to encourage companies to fund their pension schemes. So most German companies opt for pay-as-you-go (PAYG).

The Netherlands is the only continental European country with a pensions system along American or British lines. The state provides a basic pension, equivalent to half the minimum wage, through an unfunded PAYG system. To supplement this, most Dutch companies provide their employees with pensions. The law requires that these be funded, and their investment strategies have to be approved by the country's pensions and insurance regulator. As the funds typically park half of their assets in equities and the rest in bonds denominated in euros, they are facing funding gaps not hugely different from those of companies in America and Britain.

While individual European Union governments are prevaricating over pensions reform, Brussels bureaucrats keep trying to unify the EU pensions market. But little has been achieved to date. For as long as the differences between countries' rules remain so pronounced, multinationals have to tailor their pension schemes to each country. When they move employees from one to another, they have to adapt their schemes to individual cases. For instance, any employee who, say, used to be part of the generous public pension system in France has to be compensated for being posted to England, where state pensions are far more frugal.

Some companies simply park their employees' pension money offshore—in the Channel Islands, for example. “Without tax changes and social-security reform, companies won't be able to offer one pension scheme,” says Morgan Stanley's Mr Rubenstein. He is pessimistic about the efforts in Brussels to unify the EU's pensions market.

With or without a properly functioning single market, continental countries will have to find a way to reduce the share of retirement income financed from taxes. Private pension funds and insurance policies are the only alternative. But do the investment strategies of those in charge of private pensions need rethinking? In particular, are equities a fit investment vehicle for providing for old age?

Mr Bodie says that, contrary to conventional wisdom, equities are not a prudent investment over the long run. He argues that, instead of focusing on the probability of equity returns outperforming bond yields, pension-fund trustees ought to consider a worst-case scenario. In the long run, the probability of positive equity returns increases, but the danger of continuous losses also rises. With investments in fixed-income assets, on the other hand, a known obligation is matched with assets of a predictable value at the maturity of that obligation.

Mr Bodie is thus a big fan of the decision by Boots, a British health-and-beauty retailer, to shift all its pension assets into a mix of inflation-linked bonds, credit swaps and bonds that are not protected against inflation. John Ralfe, the architect of Boots's move into bonds, is one of corporate Britain's few supporters of FRS17. The defined-benefit scheme at Boots is fully funded.

Mr Ralfe has left the company since he engineered Boots's withdrawal from the equity market, but on April 14th the company defended its decision to put all its pension fund's assets (of £2.5 billion) into bonds. However, rumours suggest that Boots is toying with the idea of reversing some of its pioneering policy.

There are other examples of funds putting almost all their pension eggs into a fixed-income basket. For example, nearly 90% of the assets of Siefores, Mexico's private pension funds, are invested in government bonds, and the Texas Municipal Retirement System has invested all its assets in fixed-income instruments since 1987 when it sold its last shares (in IBM). The scheme now manages about $10 billion for 783 Texan cities. Its trustees are not restricted to debt; they can buy equities at any time. For the moment, however, they are sticking to their debt-only policy, a policy that leaves them exposed to the risk of inflation. There are simply not enough inflation-linked, fixed-income instruments around to remove that.

Incubate your own nest egg

One way for companies to resolve their dilemma is for them to get out of the pensions business altogether. Many of them have made the first move in this direction by closing their defined-benefit schemes to new members and offering defined-contribution (or “money purchase”) plans instead. Employees are not, in general, happy about the switch. Many of them prefer the paternalism of the old regime, and are afraid of the investment risk that they are being expected to carry for themselves. Yet in a modern economy, where people change jobs frequently (not to mention countries), money-purchase plans make more sense. According to a study by the Pensions Institute at the University of London, someone in Britain who changes his or her job six times loses more than a quarter of the benefits from a defined-benefit scheme.

Should companies continue to be responsible for the welfare of their employees in their old age? It is the role of government to provide a basic safety net for citizens. And it makes little sense for companies to be running the pension funds of their increasingly transient employees. In future, they would be wise to encourage their staff to look after their retirement funds properly. But why do it for them? It's not their business.

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Emerging markets

Dealing with default

May 8th 2003 | WASHINGTON, DC
From The Economist print edition

Developing countries are issuing new bonds that should make it easier to clear up or head off defaults

GEORGE BUSH'S Treasury Department has a mediocre reputation in international economic circles. Mr Bush's first Treasury secretary, Paul O'Neill, was known more for gaffes than for gravitas. His affable successor, John Snow, has been too busy trying to sell Mr Bush's tax cut at home to show much interest in matters abroad. On the international scene, Team Bush pales in comparison with Robert Rubin and Larry Summers, Bill Clinton's Treasury secretaries. Yet the Bush administration may have more influence on one of the most pressing questions in international economic policy than the Clinton crew ever did: how can the debts of developing countries be restructured?

John Taylor, the top international man in Mr Bush's Treasury, has long touted a market-based approach to dealing with sovereign-debt crises. He is sceptical of the International Monetary Fund's proposal for a "sovereign-debt restructuring mechanism" (SDRM), which would create, in essence, a watered-down international bankruptcy court. Mr Taylor prefers to encourage solutions to debt problems by persuading emerging economies to introduce "collective-action clauses" in their bonds.

Should the risk of default loom, these clauses would prevent smallish minorities of creditors from blocking restructuring deals to which large majorities had agreed. In theory, they should make defaults easier to deal with. They have long been used in bonds issued in London under English law, but have never been widespread in the much bigger New York market. During the Clinton era, there was a lot of talk about encouraging emerging borrowers to use collective-action clauses, but no action, largely because developing countries were worried that such clauses would raise their borrowing costs.

A collective change of heart

In recent months all this has changed. The IMF's proposal was shelved indefinitely at the Fund's spring meetings, and collective-action clauses have sprung to life. In February, Mexico—long a vocal critic of the notion—issued $1 billion of 12-year debt that included such clauses in New York. On April 29th, Brazil sold $1 billion of similar bonds. In perhaps the most important test of Mr Taylor's ideas, Uruguay is offering to swap much of its debt for new bonds containing collective-action clauses. According to Michael Chamberlin of the Emerging Market Traders Association in New York, there is now such momentum behind bonds with these clauses that they will "become the norm".

Why have borrowers changed their minds? One reason is fear. Once the SDRM was mooted—a far worse idea than collective-action clauses in borrowers' eyes—the thought that it might be put into effect focused minds on the search for a market-based alternative. American pressure also played a part: the Treasury made no secret of its preference for the new clauses. And then self-interest led Mexico to go first. It hoped that by starting the ball rolling it would brand collective-action clauses as a sign of a good credit, rather than of weakness.

On the investors' side, the belief that they might balk at collective-action clauses seems to have been unfounded. Far from requiring a premium, they oversubscribed Brazil's issue several times. One Wall Street insider says that the clauses were “a footnote” to the recent issues, which investors barely noticed.

Will the new-style bonds really make defaults easier to clear up? Uruguay's restructuring may provide the first test. Two years ago, the country was an investment-grade borrower, with a reputation as a well-run, small financial centre, the Switzerland of Latin America. It has been hammered by a long recession, the fall-out from Argentina's financial crisis and a plunging peso. Uruguay has around $11 billion of public debt outstanding, and now stands on the brink of default.

To give itself some breathing room, the Uruguayan government made investors an offer on April 10th: would they care to swap $5.1 billion of old bonds for new ones with longer maturities? Of the existing debt, $3.5 billion was issued abroad. If they agree, investors will suffer no loss of principal, but Uruguay's amortisation payments will be deferred for five years. The interest rate on the new bonds will also be far lower than the yields at which the country's debt now trades. To entice bondholders to accept the deal, the Uruguay government is offering some cash up-front. It has also devised cunning ways of making the existing bonds much less attractive if the deal goes ahead.

Investors have until May 15th to sign up. If 90% or more give their assent, the deal will go ahead automatically. If less than 80% agree, it will fail and Uruguay will almost certainly default. If between 80% and 90% say yes, the government will choose the outcome. Most market participants reckon that the swap will go ahead.

Less clear, however, is whether the extension of Uruguay's debt maturity will be enough to solve the country's debt problems. Although the swap is heavily backed by money from the IMF and other financial institutions, Uruguay will still have to maintain tight control over its fiscal policy and to engineer—or hope for—a return to economic growth. Michael Mussa of the Institute for International Economics, a Washington think-tank, a former chief economist at the IMF, gives the deal a 50% chance of averting a later restructuring. He argues that, in order to bump up the probability that the restructuring would put an end to Uruguay's debt problems, investors would probably have had to accept a bigger hit. They would have been highly unlikely to take that.

Look what happened next door

Doubters point to Argentina. In June 2001 it too went through an IMF-backed pre-default restructuring, which proved insufficient to prevent a chaotic default later. However, Uruguay's chances look better. Unlike Argentina then, Uruguay may be past the worst of its economic problems. Argentina's debt swap involved no losses for investors: in return for deferring maturities, they were paid a handsome interest premium. In the Argentine deal, a lower proportion of the country's debt was covered than in the Uruguayan arrangement. And Argentina's debt swap, unlike Uruguay's, made no effort to make any future restructuring smoother.

Indeed, the design of the Uruguayan bonds goes beyond collective-action clauses. There is also a mechanism allowing the votes of holders of different bonds to be added together in a future restructuring of the debt. Thus an individual bond can be restructured if 75% of bondholders agree; a series of bonds can be restructured even if only two-thirds of the holders of one bond agree, provided that 85% of all bondholders are on board.

With luck, these mechanisms will never be needed, as Uruguay's period of grace allows it to grow out of its debt troubles. But if Uruguay stumbles again, and needs to negotiate with its creditors once more, then the worth of collective-action clauses will be tested—as will the value of Team Bush's ideas.

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Bank regulation

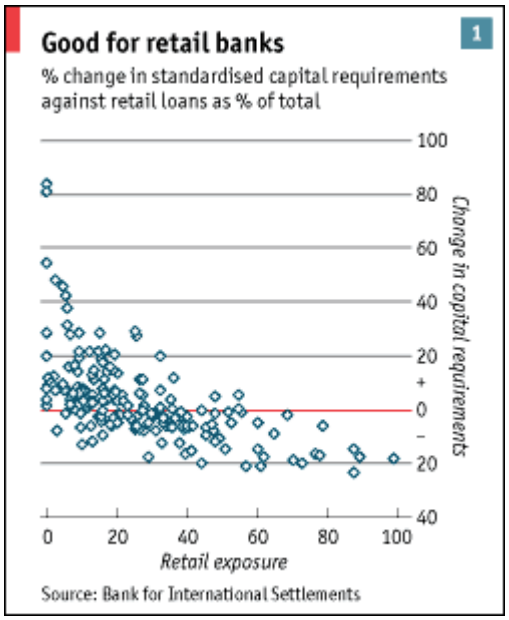
Deep impact

May 8th 2003
From The Economist print edition

Judging the effects of new rules on bank capital

A CHANGE in international rules on bank capital looks inevitable. Most banks, at least in Europe, seem resigned to this, even though for some it will mean big increases in capital requirements. Admittedly change will not come until January 2007, when the new rules known as Basel 2 are scheduled to take effect. A recent consultation paper from the Basel committee on banking supervision is meant to be almost the last word. Its numbers stem from a third quantitative impact study, published on May 5th, of the effect of Basel 2 on the capital charges of 365 banks.

The average impact seems acceptable: a decrease in charges for many classes of credit risk, offset by a totally new charge for operational risk—the risk of all manner of mishaps and foul-ups, from a lost document to a bomb blast. That leaves the overall minimum regulatory capital in the banking system about the same as now, as the Basel supervisors had promised. National regulators will be expected to add more charges, at their discretion, to keep their banks well above the minimum.



But the devil is in the detail. Hardly any bank represents the average. Many banks specialising in such areas as securities custody and asset management are royally browned off. Thanks to the new operational-risk element, these products attract a capital charge for the first time. On the other hand, banks that focus on retail and small-business lending have reason to celebrate. Their capital charges may fall by up to 20% (see chart 1).

Does Basel 2 align capital charges and the risks in the financial system more accurately than the present regime, Basel 1, which has been in force since 1988? Almost everyone agrees that Basel 2 is taking banks' regulatory capital closer to “economic capital”, the theoretically ideal cushion against unexpected losses. But opinion is divided over whether this is a good thing. Some critics claim the process does not go far enough: it does not yet allow banks to use evolving techniques, such as portfolio models of credit risk, to get ever closer to economic capital. Others fear that the Basel 2 calculations are too finicky and costly to make economic sense for all but the biggest banks.

Both schools of critics worry about unintended consequences. For example, according to the Association of German Banks, if Basel 2 had been applied to banks in March 1998, the average capital charge on a portfolio of loans to around 4,000 European companies would have been around 4% of the loans outstanding. Fast-forward to February 2003, by when more firms looked closer to default: the implied capital charge had roughly tripled (see chart 2). What does this tell us? That five years ago the discipline of Basel 2 would not have discouraged imprudent lending by banks? Or that capital charges in a harsh credit climate will be prohibitive and discourage lending when companies need it most? Both answers are plausible.

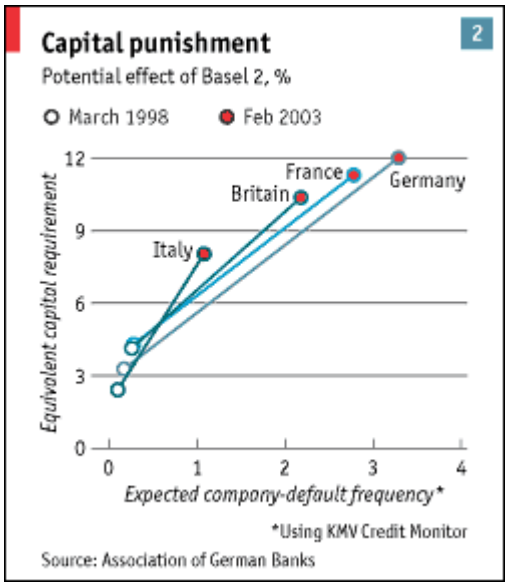
One or two European banks even believe that Basel 2 could, at worst, blow up one or two European banking systems. Of course, the worriers concede, the data are not perfect. (They are derived from premiums for default risk inferred from equity and bond prices by Moody's KMV, a Californian data company. Default premiums have recently been highly volatile and should probably not be the only basis for capital calculation.) However, the banks' basic point still stands: the more sensitive the capital calculation is to risk, the more volatile the capital requirement is likely to be. If too many banks require

extra capital at the same time, that alone could cause a capital crisis in the banking sector of a country, or an entire continent.

Alarmist? Perhaps. In Germany, after all, the banks are already undergoing a capital crisis of sorts without any help from Basel 2. And because regulators have been fine-tuning their calculations at the bottom of the business cycle, there may be less danger that Basel 2 will spur reckless lending when conditions improve. Moreover, because national regulators will be expected to add charges according to the quality of the banks' management and their mix of business, there is some scope for flexibility.

However, the danger of giving discretion to regulators is that practice will vary from country to country. For this reason the Basel committee is spending almost as much time on co-ordinating supervisors as it is with banks. But there are two big potential sources of discrepancy. The first is between America and Europe. American supervisors have said that Basel 2 will be mandatory for only ten internationally active American banks, while ten more may adopt the regime voluntarily. Other American banks will be supervised according to the cruder Basel 1, with a few local enhancements. Across the Atlantic, the European Union is committed to writing Basel 2 into EU law, to be applied to all banks and investment firms regardless of size and scope.

Second, there may be inconsistency within Europe. Even when Basel 2 becomes law across the EU, its implementation will rely on rule-making in 15—soon to be 25—member states, and thereafter on the discretion of national regulators. This will give supervisors plenty of scope to favour their national champions. Within the euro area, they might even try to use their powers as an instrument of macro-economic policy. Deprived of the means to fiddle with interest and exchange rates, these supervisors, some of them former central bankers, may be tempted to exercise selective forbearance on the banks.



Some critics of Basel 2 would say that bank supervisors have been too selective already, by tweaking their calculations so that lending to retail and small-business customers will not be jeopardised. If lending to those sectors later proves to have been reckless, then these very clients—either as consumers or as taxpayers—will in any case end up bearing a large share of the cost.

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About sponsorship

John Gutfreund

Resurrection

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From The Economist print edition

A Wall Street legend seeks to recapture former glories

IN MORE ways than one, this is clean-up time on Wall Street. Rotten as the big investment banks look, their hold on underwriting is becoming firmer. The number of banks leading initial public offerings has collapsed from a peak of 170 in 1996 to a mere seven so far this year. Most of the niche investment banks that were around in the early 1990s, such as Robertson Stephens, Montgomery Securities, Hambrecht & Quist and Alex Brown, have been absorbed by bigger firms, if they exist at all. Even big names are disappearing. In an effort to tidy up its brand, Citigroup has killed off the name of Salomon Brothers, a firm it bought for $9 billion in 1997.

Could there be a worse time for a comeback? Yet John Gutfreund, the man who led Salomon at its peak, is attempting just that. Cast out of Salomon and the industry in 1991 after a trading scandal (which curiously benefited the supposed victim, the American government), Mr Gutfreund spent a decade out of the limelight. He ended up with no severance package, after a dispute over its size. He was a director of what he calls “a few crappy companies”. Occasionally he would be quoted scoffing at the over-valuation of the stockmarket. Now 74, he still may not run a securities firm without the say-so of the Securities and Exchange Commission—a penalty that looks ludicrous when Wall Street's current leaders have escaped scot-free.

Yet Mr Gutfreund is free to lend a hand. Willing to grasp it is C.E. Unterberg Towbin, an investment bank founded during the Depression that has had its own ups and downs. From the 1960s to the mid-1980s, it prospered underwriting technology companies, notably Intel. It was dissolved in the late 1980s, then re-emerged in the 1990s as an underwriter of companies in technology, health care, and consumer products that were too small for the big banks. It was a good niche, but when Mr Gutfreund arrived as a senior managing director 15 months ago, the firm was losing money. It is now breaking even. “He brought stability,” says Unterberg's co-chief executive, Andrew Arno. “And a terrific Rolodex did not hurt.”

It probably also does not hurt that Mr Gutfreund has something to prove. He arrives for work by 8am and often leaves after 7pm. He works on deals and strategy, and reassures customers. He also applauds Unterberg's retention of a partnership structure. Salaries are low for Wall Street, no more than $100,000, but profits, if there are any, will yield huge bonuses. At Salomon, Mr Gutfreund helped to end one of the great Wall Street partnerships by merging it into a public company. This, he says, caused the partners to lose interest.

Since his arrival, Unterberg's staff has shrunk from 240 to 125, but Mr Gutfreund says the changes have not gone far enough. The firm has one star investment banker, Tom Unterberg, a specialist in technology underwriting. Its other investment bankers are merely good and need to be better. The traders are fine, but the sales force ought to be improved. Mr Gutfreund would like to build a bond-trading operation, a core strength at Salomon. The desired refurbishments, however, will cost the firm more that it can now pay.

For a small investment bank in such times, this is no easy task. A bank's underwriting capacity depends on the amount of capital it can put at risk. The smaller a bank is, the harder it is to attract the necessary capital—and hence to grow. Unterberg's aim is to be the bank of choice for firms with market capitalisations under $500m, but war and the weak economy have made this corner of the market particularly quiet. So far this year, Unterberg has been involved in two smallish deals: a secondary

offering for Cray Research, a maker of supercomputers that Mr Unterberg helped to go public many years ago; and a complicated operation for Indus, an Atlanta software manufacturer, to raise money for an acquisition.

Another dozen deals are being seriously discussed. It would be good news if half went through. Companies and investors are adjusting to the new environment, says Mr Gutfreund, providing some light in the gloom, but the process is slow. People remain haunted by recent losses. Mr Gutfreund is forthright in acknowledging that, at his current age, he has a “limited shelf-life”. His legacy on Wall Street may depend on whether that can be sustained until the market turns.

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Currencies

Super-euro

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Europe's once sickly single currency is flexing its muscles

THIS week the euro rose to $1.14, 36% above its low point of two years ago and within spitting distance of the rate of $1.17 at which it began life in January 1999. Yet despite the currency's recent strength, which will surely squeeze growth in the euro zone, the European Central Bank left interest rates unchanged at 2.5% at its meeting on May 8th—in line with most economists' expectations.

The euro was clearly undervalued early last year, but the speed of its appreciation has taken many by surprise. The dollar's ascent against the euro in 1999-2001 was popularly explained by America's superior economic performance. Yet America's growth is still outpacing Europe's, so why is the dollar falling?

Over the years, currency theories move in and out of fashion. Growth differentials are, it seems, no longer relevant; currencies are being driven instead by trade imbalances and differences in interest rates. Investors have become less willing to finance America's huge current-account deficit and are taking advantage of higher European interest rates. The large flows of capital from Europe into the United States seen a few years ago have now dried up. European investors, who suffered big losses on their dollar assets, are wisely keeping their money at home. Since its low point in March, Germany's DAX share index has gained 36%, more than double the rise in the S&P 500.

Judged by purchasing-power parity (PPP)—ie, by comparing relative prices—the euro is now slightly overvalued against the dollar, but there are good reasons why the euro could rise further still. First, as a result of years of external deficits, America has built up large foreign liabilities and hence debt-service payments, so it needs to run a trade surplus if it is to move towards current-account balance. This means that the dollar needs to be cheaper than its PPP.

Another reason why the euro is likely to overshoot is that it will have to shoulder a disproportionate share of the dollar's decline. This is because several of America's trade partners are resisting a rise in their currencies. Japan has been intervening to hold down the yen, while the Chinese yuan is fixed against the dollar. So, for any given fall in the dollar's trade-weighted value, the euro will have to rise by more.

Many forecasters are betting on a 10% increase in the euro over the next year or so. A much steeper rise is possible. After hitting its low in February 1985, the D-mark climbed by 90% against the dollar in the next two years. If the euro were to rise by this much from its lowest point, it would reach $1.60.

American policymakers would probably be happy with a cheaper dollar to help reduce the risk of deflation. The Federal Reserve's open market committee gave warning this week that inflation could fall from its already low levels. The Fed left interest rates unchanged (see article), but with rates at 1.25% it has little room for further cuts. A falling dollar, on the other hand, has a similar impact to lower interest rates on growth and inflation.

According to the Fed's economic model, a 5% fall in the dollar's trade-weighted value has roughly the same impact on GDP as a half-point cut in American interest rates. Since January 2002, the dollar has fallen by 17%, and interest rates have been cut by half a point. The overall loosening of monetary conditions has therefore been equivalent to a cut in interest rates of about two percentage points.

In contrast, in the same period the euro's trade-weighted value has risen by 16%, while the ECB has cut interest rates by three-quarters of a percentage point. In the euro area a 5% rise in the exchange rate is estimated to be equivalent to a one-point increase in interest rates (more than in America, because exports account for a bigger share of GDP). This implies an overall monetary tightening equivalent to a 2.25-point rise in interest rates. No wonder the economies of the euro area have continued to underperform America's.

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Gold

Bullion for a billion

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Chinese reforms could lift gold's fortunes

IN UNCERTAIN times, gold still retains a special lustre for some investors: although its price has fallen back from recent, war-spurred highs, it is fetching about $340 an ounce, up from $280 at the beginning of 2002. Yet gold's golden age, so to speak, is long gone. Since the 1970s it has become almost like any other precious metal, and increasingly one that central banks no longer care to hold in reserve.

That is why the gold industry is looking to China in hope. For decades the country severely restricted the buying and selling of gold, which put a heavy damper on demand. Now, however, China is liberalising. When India did likewise in 1996, it promptly overtook America as the world's largest consumer. China, now in third place, might also begin to climb the league.

Until last year, its central bank fixed the domestic price of gold. It bought all the gold produced by China's 1,000 or so mines and allocated it to jewellers. This ended in October when a gold exchange opened in Shanghai where producers and wholesalers trade directly with one another. In March, the central bank went further and gave up its power to license producers and retailers. Now anybody can enter the gold business in China.

A far bigger change is planned for June, when individuals will be allowed to invest in gold, either by buying ingots or by opening gold accounts at their banks. China has one of the highest savings rates in the world, officially about 40%. But its mutual-fund industry and stockmarkets are fledglings, so the Chinese keep most of their money in humdrum bank deposits, which pay a miserly 2% in interest before tax. If India's experience is a guide, many will now shift their money into gold.

This will drive up prices inside China. Since Chinese demand (200 tonnes) already outstrips domestic production (190 tonnes), it will also lead to more imports. International trade, however, is one aspect that the central bank is not eager to liberalise. Its biggest task during this decade is to prepare the yuan for convertibility. But until that happens it will be wary of free international flows of gold, which could serve as a proxy for hard currency.

Still, even this is only a matter of time. “Gold has no boundaries,” says Albert Cheng, a director of the World Gold Council, an industry body that has been lobbying the Chinese government for a decade. “If China's demand goes up, it will help everybody.”

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Economics focus

Behaviourists at the gates

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How economists are using psychology to question orthodox policy prescriptions

ANYONE who has read even a bit of economics knows how arid it can be. Pages filled with squiggly equations describe a world occupied not by fallible, generous people like you, your family or your friends, but by “agents” and “actors”, all as rational as Star Trek's Spock and as greedy as Gordon Gekko.

Yet most economists rather like the dryness of the dominant, neoclassical strain of their discipline. Its lack of detail about how people behave in the real world, much bemoaned by its critics, is actually a strength. It gives economic theory great flexibility, especially when mathematical techniques are brought to bear. Starting from the idea that people are rational—meaning, in essence, that their tastes and therefore choices are consistent—economists can examine a huge array of theories and policies. Neoclassical economics tends often, though not always, to conclude, much like this newspaper, that the best policies tend to be liberal ones: free trade, a limited role for governments, lower taxes. The flexibility of neoclassical economics has also allowed its techniques and prescriptions to infiltrate other social sciences, such as sociology, political science and anthropology.

Neoclassicism and its discontents

For years, some dissident economists have been quietly chipping away at the micro-foundations of the neoclassical edifice and the policy conclusions built upon them. Now their efforts seem to be gathering force on American university campuses, where most American students meet *Homo economicus* for the first time. Although the dissidents' methods might one day lead to a clearer understanding of the basics of economics, the results so far have been of limited value—judged at least against the dissidents' grand ambitions.

The most striking development has been a move at Harvard, which has one of America's biggest and most influential economics faculties, to offer an alternative to the basic undergraduate economics course taught by Martin Feldstein, a former economic adviser to Ronald Reagan. Mr Feldstein's course is typical of the neoclassical approach.

The new course is being proposed by Stephen Marglin, a tenured professor who earned his chair largely for research that attempted to square a Marxian approach with Keynesian demand theory. One basis of the proposed course and others like it, however, is the rapid uptake of the ideas of behavioural economics. This uses lessons from psychology to undercut the idea of *Homo economicus* as a rational being. Many of these ideas are based on the work of Daniel Kahneman, a psychologist and winner of last year's Nobel prize in economics, and his collaborator, Amos Tversky, who died in 1996. They highlighted, through a number of experiments, the various ways that people perceive and misperceive risks.

Behavioural economics is a fascinating field. On its face, moreover, it seems to undermine the neoclassical orthodoxy. It suggests that people, contrary to the basic assumptions of the standard approach, do not always behave rationally. They may avoid slight risks, and yet take wild gambles. They may fail to save for the future, although they have the means to do so and a good prospect of a long life. They may not be able to choose how to spend their money in a way that maximises their “utility”, economists' jargon for happiness. They may have no idea how to attain happiness. More than this, people are not entirely selfish. Parents seem to give up a lot for their children. People give money to charities, churches and buskers with no apparent gain to themselves.

What are the implications of these ideas for policy? According to Mr Marglin, they are profound. What if

people cannot even calculate the amount they are willing to pay for a pound of butter or a haircut, or have any idea what prices will be in the future? In such a world, such basic constructs as demand and supply curves—which show the quantities that people and firms would be willing to demand or supply at given prices—lose their meaning. The normal economic calculations of costs and benefits—for example, of the costs created by a tax increase or the imposition of a tariff—depend on estimates of these curves. These calculations, and the policy conclusions that follow from them, may therefore be threatened by the behavioural approach.

This helps unorthodox economists in a range of debates with those in the mainstream. Support for school vouchers, for example, relies crucially on the notion that people know what is best for them, or at any rate for their children. Free trade relies on the benefits that occur to many from lower import duties, set against the costs suffered in the form of lost jobs in industries competing with imports. But if these things cannot be measured, or even theorised about sensibly, the rationale seems to melt away. Mr Marglin would have students read about the travails of unemployed textile workers in the American South who have lost their jobs thanks to NAFTA, rather than wade though econometric studies of the net benefits of the trade agreement to the American and Mexican economies.

So is *Homo economicus* doomed to be toppled? Not yet. There is no clear evidence that people's failure, at least some of the time, to behave rationally should be a bar to the neoclassical model. As Milton Friedman noted decades ago, it is enough that people behave more or less “as if” they are rational. And people's mistakes might all come out in the wash: for every one who saves too little, someone else might save too much. Supply and demand curves are still informative devices.

The heterodox economists, however, deserve credit. Their bold move to offer students an alternative should be applauded for comprehending that students are consumers. That said, if consumers cannot be trusted to know what is best for them, how can students know that they have chosen the right course?

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About sponsorship

Nanoelectronics

On the tube

May 8th 2003
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A new type of computer memory uses carbon, rather than silicon

Get article background

WAITING for a computer to turn on is a nuisance. That is why manufacturers have been trying to create “non-volatile” memories. These would be fast, like the random-access memory (RAM) chips that are currently used for often-accessed memory, but they would also continue to store information even without power, like hard drives, which are too slow to use except for long-term storage.

Several technologies have been competing to become the standard for fast, non-volatile memory. The best known is magnetic RAM, which IBM and Motorola are touting. Others are based on polymers or on strange-sounding metal alloys called chalcogenides that change shape when an electric charge is applied to them. But there is now a new entrant to the field: carbon.

New element on the block

Carbon comes in many forms. Diamonds and graphite are two of the most familiar ones. A less familiar variety is the nanotube, also known as a “buckytube” after Richard Buckminster Fuller, whose geodesic domes have a framework similar to the arrangement of the atoms in a nanotube. Nanotubes consist of a cylindrical array of carbon atoms whose diameter is only about 1 nanometre (a billionth of a metre). If Nantero, a firm based in Woburn, Massachusetts, proves correct, such tubes will soon be an integral part of computer memories.

Nantero's memory chips consist of billions of nanotubes, each a few hundred nanometres long, suspended from a silicon wafer. Another wafer sits about 100 nanometres below the first. Because the nanotubes that Nantero uses conduct electricity, a small electric charge at one point on the second wafer will draw several dozen nanotubes towards it. Once they are there, they stay there. That is because they are bound by Van der Waals forces—intermolecular bonds that do not depend on external power for their maintenance. An additional application of current, however, will release the nanotubes. This means that a group of a few dozen nanotubes can act as a memory element, storing a single bit (either a one or a

zero) of the binary code that computers use to operate. If the connection between the wafers is live at a particular point, the bit represented is a one. If not, it is a zero.

If nanotubes were not so small, this would not be a big deal. Because they are, though, Nantero's technology can already achieve a data density considerably higher than existing RAMs. And because the wafers are so close together, those data can move rapidly from place to place. Nantero's new memory can read or write a bit in as little as half a nanosecond (billionth of a second). The best RAM chips, by contrast, need ten nanoseconds to perform a similar operation.

At the moment, Nantero has only a working prototype. But the firm aims to have memories on the market within a year. It thinks it will be able to tool up for commercial production quickly, because the fabrication technique it uses, though novel, relies on standard semiconductor-making technology.

The main difficulty faced by others who have tried to go down the buckytube route is getting the tubes to align with each other when they are hung from the first wafer. Until now, the approach has been to try to grow all of the tubes in the correct orientation to start with. But Nantero's founders came up with a simpler, if less elegant, solution. They use established lithographic techniques to get rid of tubes that are pointing in the wrong direction by zapping them with an electron beam. That leaves only those that are hanging down towards the opposite wafer.

Though the recent chip is certainly impressive, the reason for getting excited about Nantero is not so much the present as the future. Unlike silicon, which is pushing against its physical limitations, carbon-nanotube technology is in its infancy. Greg Schmergel, Nantero's boss, says that within the next few years the firm's engineers may be able to achieve data densities of a trillion bits per square centimetre (more than 1,000 times that available on existing RAM) and it will be possible to read those memories 100 times faster than can be done at the moment. The days of silicon-based memory may be numbered.

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About sponsorship

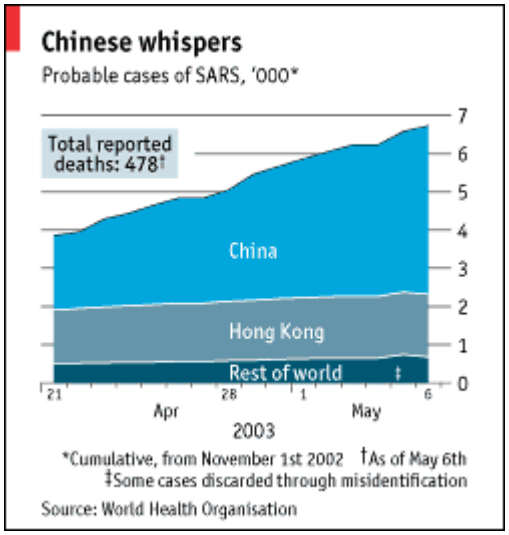
SARS

For better, for worse

May 8th 2003
From The Economist print edition

SARS looks more dangerous than it did

Get article background



SINCE the outbreak of Severe Acute Respiratory Syndrome (SARS) was first noticed, there has been a lot of debate about the disease's death rate. Initial figures published by the World Health Organisation (WHO) suggested it was in the region of 2%. That figure has now risen to 7%. The debate is about to continue with the publication of a paper in this week's *Lancet*. According to this, the fatality rate for patients in Hong Kong under the age of 60 could be as high as 13%. For those over 60, things are considerably worse. The paper estimates that around half of those above that age who catch SARS will die of it.

This paper is the first major epidemiological study to be published on SARS. Christl Donelly and her colleagues at Imperial College, London, studied 1,425 cases of SARS reported in the territory up to April 28th. They say that their fatality rates are higher than the WHO's because they have used two statistical techniques to estimate whether patients who currently have SARS are likely to live or die. The WHO's figures are based on a simple calculation, dividing the number of deaths by the number of cases, so do not include those who are eventually going to die. On the other hand, the new study does not include those who have SARS but are not sick enough to be in hospital, so the figures it comes up with could be an overestimate.

Dick Thompson, a spokesman for the WHO, said that no consensus on the death rate would be possible unless the disease became endemic, and thus reached some sort of equilibrium. This is because rates vary between places. In Vietnam, where the outbreak is over, the death rate is an indisputable 8%. In Canada, where it has not yet run its course, the rate looks likely to end up more than double that.

This, says, Mr Thompson, is because the outbreak in Vietnam was largely confined to health-care workers between the ages of 20 and 50. In Toronto, SARS spread into the wider world, and thus infected a number of older people as well. The most recent fatalities in Hong Kong, which have been disproportionately in people aged between 75 and 90, also show that SARS is very much a problem in the elderly.

In addition to estimating fatality rates, Dr Donelly's study took the first detailed look at the virus's incubation period, by examining 57 patients who had short and defined periods of exposure to SARS. It found that the average incubation period was just over six days, and that 95% of patients would develop the disease within 14 days of exposure. The standard quarantine period for SARS is ten days.

Azra Ghani, one of the authors of the *Lancet* paper, says that she and her colleagues found no relationship between the speed that a victim was admitted into hospital and the outcome of the disease. But they did find, not surprisingly, that the more quickly people were admitted into hospital in an area, the less the infection spread. The average time from the onset of symptoms to hospital admission varied from three to five days. These figures, says Dr Ghani, have become significantly shorter in the past two weeks. Thus, the researchers believe that increased vigilance by public health authorities in Hong Kong is playing an important role in the declining number of new cases of SARS.

A critical question at this stage is how many other people each victim will infect. As Dr Ghani points out,

this must be reduced to less than one for the outbreak to be contained. Researchers at Imperial College have been working on this question, too, and have submitted their research on the subject to *Science*.

Meanwhile, other news this week showed that the virus which causes SARS can remain stable on some open surfaces for up to two days. That, on the face of things, is worrying. But it should not be cause for over-reaction. Julie Gerberding, director of the Centres for Disease Control and Prevention in Atlanta, Georgia, cautioned against misinterpreting these findings, explaining that there were similar reports two decades ago about HIV. In that case, though, the presence of the virus in body fluids left on surfaces was not important in the transmission of the disease.

The experts still believe that SARS, too, is transmitted principally from person to person, in this case through exposure to infected droplets expelled during coughing and sneezing. Other recent work has underscored the need for masks, regular handwashing and good disinfection in hospitals managing SARS patients.

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Treating cancer

Set a thief to catch a thief

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Viruses can kill a form of brain cancer

IT HAS been known for a long time that some cancers are caused by viruses. The idea that a virus might be used to cure a cancer, though, is a novel one. But if work just published in the *Journal of the National Cancer Institute* by Juan Fueyo of the University of Texas and his colleagues turns out as its authors hope, that novelty may eventually be converted into reality.

Dr Fueyo's experiments were on a type of brain cancer called a glioma. Gliomas are particularly difficult to treat with conventional therapies. They resist surgery, radiotherapy and chemotherapy. And they generally kill within a year. What is needed is a way of destroying the glioma cells, while leaving healthy ones intact. This is what Dr Fueyo thinks his viruses might eventually do.

The trick depends on genetic engineering. The viruses concerned, a type of adenovirus (one of the classes of virus that cause colds) were modified in two ways to make them attack only glioma cells. The first change was to the gene for a protein called E1A. This protein binds to a human protein called Rb. In a healthy cell, the role of Rb is to regulate cell division. The characteristic of cancers is that their cell-division regulation has broken down, and in many cases, particularly gliomas, this is because a mutation has stopped the production of active Rb. And Rb has a second job. The way it regulates cell division is by stopping DNA from duplicating. As a consequence, it also acts to stop viral DNA duplicating, which means that it helps to prevent viral infections. Adenoviruses with E1A, however, are immune to this effect because the E1A neutralises the Rb. By disabling the E1A gene in his viruses, Dr Fueyo created a strain that could infect glioma cells (which have no functional Rb) but not healthy cells (which do).

The second modification was to a protein that allows the virus to lock on to a cell's outer membrane, prior to infecting it. Normally, adenoviruses link up to a protein called CAR. One of the changes that happen to glioma cells is that production of this protein drops off, making them almost immune to infection. The team therefore altered a viral protein called fibre knob, so that it would bind strongly with a second cell-membrane protein, called integrin, that is not affected when a cell becomes cancerous.

To find out whether the engineered virus had the desired effect, the team implanted human glioma cells into the brains of experimental mice. These mice had had their thymuses removed. The thymus acts as an incubator for the cells of the immune system that detect and destroy foreign tissue. Removing it allows human glioma cells to thrive in a mouse's brain.

In the absence of the modified virus, they duly did so. On average, untreated mice lived for 19 days. Those infected with the virus did much better. Indeed 60% of them were still alive after four months—which in the context of such a short-lived animal was regarded as a complete cure.

Examination of the brains of these long-lived mice suggested that they had, indeed, been cured. The tumours had vanished. If human experiments, due to start next year, have equally good results, gliomas may at last have met their match.

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Herbivorous ants

Veggieburgers, anyone?

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Ants seem to be a lot more vegetarian than entomologists had realised

THERE is something odd about tropical rainforests. They have too many ants in them. Ants are carnivores, so they should be near the top of the food chain. That means they should be less abundant than the creatures they eat. But they are not. “Fog” the canopy of a rainforest tree with insecticide to see what falls out, and the answer is a lot of ants and far fewer of the other sorts of arthropod (insects, spiders and other creepy-crawlies) that ants are presumed to feed on. Indeed, ants form about 90%, both by weight and by numbers, of the critters collected this way.

That is almost exactly the inverse of what would be expected. By and large, each link in the food chain is a tenth the size of the one before it. This is because the other 90% of the energy eaten by the creatures in each link is lost or used for metabolic processes, rather than being converted into flesh, blood, bones or exoskeletons. Something strange is clearly going on, and Diane Davidson of the University of Utah and her colleagues think they know what it is. As they outline in a paper in *Science*, far more ants than was previously suspected are not carnivores at all. Instead, they are cryptovegetarians.

Vegetarian ants are already known. No ant species consumes plants directly by chomping pieces out of them and eating them (though some species chomp up leaves and grow fungi on them, which the ants then eat). Many ants, however, drink nectar and similar sugar-rich plant secretions. Ants also “herd” aphids and other sap-sucking insects. Sap suckers are messy eaters, and the honeydew they produce is manna to ants (indeed, some scholars think that it may also have been the manna that the Israelites ate during their wanderings in the desert). Dr Davidson's theory is that such activity is far more widespread than was previously realised, and that besides being the dominant predators in rainforests, ants may also be the dominant herbivores.

To test this idea, she looked at the isotopic composition of ants, their potential animal prey, and the local plants, in two tropical forests—one in Amazonia and one in Borneo. In particular, she examined two isotopes of nitrogen: ^{14}N and its heavier sibling, ^{15}N. These betray an animal's place in the food chain because the ratio of the two isotopes changes each time they are processed by an organism's metabolism, with the heavier ^{15}N becoming progressively more abundant.

The result of Dr Davidson's analysis was that many ant species, particularly those generally classified as scavengers of dead or dying insects, actually turn out to be as herbivorous in their diets (albeit indirectly) as specialist insect herbivores. Considering the number of ants around, that has significant implications for rainforest ecology. It suggests that the trees are under a lot more pressure from their fellow residents in the forest than people had realised. It also shows how little, after a century and a half of scientific study, the rainforests are really understood. Food for thought, as well as for ants.

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Altruistic aphids

Galling behaviour

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Aphids will protect their colonies at the cost of their own lives

APHIDS are not, you might think, the sort of creatures that would lay down their lives for their friends. But you would be wrong. A study just published in the *Proceedings of the Royal Society* by Utako Kurosu, of Tokyo University of Agriculture, and her colleagues shows that aphids are, indeed, capable of making the supreme sacrifice.

The aphids in question are not the common or garden greenfly that infest people's roses, but rather a species called *Nipponaphis monzei* that hides itself away in large galls which its activities form on the twigs of the trees that it parasitises. Unfortunately for the aphids, these galls are attractive to other animals, in particular the caterpillars of certain moths. The caterpillars like the food and shelter the gall provides.

To examine the aphids' reaction to such invasions, Dr Kurosu collected a number of galls and caterpillars from nearby woods, brought them to her laboratory, cut holes in the galls, and introduced the caterpillars. In every case the aphids attacked the caterpillars with sticky white fluid, killing them. In doing so, however, the aphids discharged about two-thirds of their body weight as fluid, behaviour likely to lead to death in the wild. Other aphids busied themselves patching up the holes with similar discharges. In this case, not only did the aphids sacrifice a lot of their body weight, many of them sacrificed their lives directly since they were trapped in the gum as it solidified.

The explanation of this self-sacrifice is that the evolution of such behaviour depends not on the moral sophistication of the creatures, but on the genetic relationship between sacrificer and beneficiary. In ants, bees and wasps, the insects best known for collaboration and self-sacrifice, a peculiar genetic system causes females to be more closely related to their sisters than to their own daughters. This results in the evolution of sterile worker females, whose role is to help their mother (ie, the colony queen) reproduce. Aphids go one better than this genetically. The aphids in a gall are a clone—all the individuals have the same genes. In these circumstances the concept of individuality is even more blurred than in an ant nest or a beehive, and the evolution of self-sacrificial behaviour is easy. Losing some “individuals” does not matter if the overall reproductive capacity of the colony is thus enhanced. In that context, it is noteworthy that the self-sacrificing individuals were the youngest nymphs. Adult aphids—that is, those old enough to reproduce—stayed out of the fray. Thus the loss to the clone's reproductive potential was minimised.

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About sponsorship

Soviet history

L'Homme Nikita

May 8th 2003
From The Economist print edition

Two new books describe how Khrushchev dealt with Stalin's legacy, and (see article) how Vladimir Putin still struggles with the Russia he inherited in 2000

THE outsized shoes that America alone now fills may lead some people to look back nostalgically at the cold war. For nearly half a century, the balance of power that existed between the United States and the Soviet Union created a modicum of stability in international relations and, some historians claim, acted as a brake on the interventionist impulses that occasionally afflicted each of the superpowers. The cold war may not have been a good thing in itself, but it was a period that came to be aptly named—in the title of a 1987 book by John Lewis Gaddis, an American historian—as “The Long Peace” within a violent century.

William Taubman's masterful new biography of the former Soviet Communist Party chief, Nikita Sergeyevich Khrushchev, is a useful antidote against such cold-war sentimentalism. A close look at the career and policies of Stalin's successor in the Kremlin documents not only the disasters that the party inflicted on the Soviet people, but also how its perception of the world could easily have led to further disasters on the international field. Khrushchev—the most impulsive and mercurial of Soviet leaders—was ultimately unable to break free of the oppressive, inflexible and fearful state that Stalin created, even after publicly condemning its creator.

Khrushchev: The Man and His Era
By William Taubman

Norton; 876 pages; $35.
The Free Press; £25

Buy it at
Amazon.com
Amazon.co.uk

Mr Taubman, who teaches political science at Amherst College, Massachusetts, and who had unprecedented access to Russian archives and oral sources for this biography, views Khrushchev's life as a tragedy, determined largely by the young Nikita Sergeyevich's lack of education, his participation in many of Stalin's crimes and by Stalin's hold on the minds of the young Khrushchev and his associates.

A capable and energetic administrator, Khrushchev enjoyed an accelerated career within the party apparatus during the 1930s, much helped by the extermination during the purges of an older generation of Bolsheviks. During the second world war he was Stalin's chief henchman in Ukraine, overseeing the expansion of the Soviet Union into Polish territory and the war against the Ukrainian and Polish partisans. Until Stalin's death in 1953 there was little that marked Khrushchev out as different from others among

the boss's minions; he displayed the same fawning servility as everyone else at the top of the Soviet state, including all of the leaders he would later push aside to become Stalin's successor.

But still, Khrushchev was different from most of those he purged when he made his grasp for complete power between 1953 and 1957. Having been an accomplice to some of the worst crimes of a blood-stained century, Khrushchev felt the need to rid himself of some of the blame by attacking his former master. Whether this was as a result of some sort of conscience—as Mr Taubman contends—or out of political expediency is hard to determine. Under any circumstances, Khrushchev's condemnation of Stalin at the 20th Congress of Soviet Communists in 1956 was certainly a brave act, and it proved to be the highlight of his career.

From then on, it was mostly downhill. Having gained power within the party, Khrushchev found that his background left him completely unprepared for the business of governing the Soviet state, not to mention its foreign policy. After trumpeting the need for détente with the West, he stumbled into the most dangerous confrontation of the cold war—the Cuban missile crisis of 1962—and nearly unleashed a third world war. His alliance with China broke down in acrimony. Domestically, he called for reform, but repeatedly returned to oppression when events turned out differently from what he had predicted. Although there is no doubt that Khrushchev wanted to change the Soviet Union for the better, by the time he was overthrown in a palace coup in 1964 he had more or less run out of choices.

Khrushchev's tragedy was his inability to break out from the system Stalin had created. Most of this failure can be attributed to the psychological hold that his former master retained over him, even after 1956. As Khrushchev told his colleagues a year after the 20th congress: “All of us taken together aren't worth Stalin's shit.” The uneducated Khrushchev, Mr Taubman concludes, “prided himself on his ability to read faces and minds, but he was lecturing, not listening, not gleaning what he needed to know to hold the empire together, but sharpening the strains tearing it apart.”

Khrushchev: The Man and His Era.
By William Taubman.
Norton; 876 pages; $35.
The Free Press; £25

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Russia today

The winding road

May 8th 2003
From The Economist print edition

IN THE course of Boris Yeltsin's unruly eight-and-a-half-year presidency, fortunes in Russia were made and destroyed, new ideologies dreamt up and endlessly rehashed. Not until Vladimir Putin took over in 2000 did life calm down and post-Soviet Russia start to take shape.

But this shape, like Mr Putin's own personality, is still unclear. Those who look at economics tend to see a country that has bounded back from its 1998 economic collapse and is now stepping firmly towards modernity. Observers of society and human rights see a grim dictatorship emerging, which offers little heed for its citizens' well-being. A book that makes sense of the contradictions is sorely needed.

Wisely, Lilia Shevtsova does not try to paint a sharply focused portrait of a country still in flux, but opts instead for a chronicle. She describes how Mr Putin has grown as a leader, how he has gradually shaken off his ties to the Yeltsin clan and surrounded himself with his own people, many of them from the security services. Mr Putin consolidated his power and created stability by crushing or co-opting every institution that might threaten his authority. It looks all too much like a return to the Soviet model. And yet it gained him the freedom and self-assurance to bring about economic reform and rapprochement with the West—policies he believes Russia must pursue to survive.

Ms Shevtsova, a noted Russian scholar, offers many insights into Kremlin court politics, as well as Mr Putin and his foes. She often comes back to the impact that recent events have had on Russian society, and uses this as a way of explaining how the chaos of the Yeltsin years exhausted the country and made it hunger for order, even to the point of accepting unpopular causes such as the war in Chechnya.

But the book, like Mr Putin's presidency itself, is sometimes confusing, jumping from theme to theme without always making the necessary connections. Disappointingly, Ms Shevtsova is sketchy about how Mr Putin actually got to be president. Mr Yeltsin, she believes, saw in his protégé a loyal man who would protect him after he left office. But she does not explain how Mr Putin—at the time a senior but unremarkable official in the St Petersburg city government—attracted Mr Yeltsin's attention in the first place.

The book's main weakness, though, is that Ms Shevtsova wants to prove a point. Disturbed by Mr Putin's authoritarian tendencies, she cannot resist lecturing him. “Government is always a balancing act, and balancing authoritarianism and the market is an even trickier one,” she notes; but she omits to mention that such a balance can be sustained for a long time, as in Augusto Pinochet's Chile. By refusing to take a cool-headed look at such a possibility, Ms Shevtsova denies herself and her readers a clear view of all the ways that Mr Putin's Russia might go from here.

Putin's Russia.
By Lilia Shevtsova.
Carnegie Endowment for International Peace; 298 pages; $19.95 and £29.75

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About sponsorship

America's black economy

Pot, porn and prison

May 8th 2003
From The Economist print edition

HOW free is the free market? Not very, insists Eric Schlosser, an American journalist, in his new book, “Reefer Madness”, the follow-up (and in some ways a companion volume) to his 2001 bestseller, “Fast Food Nation”. Witness the booming black market. In 1998 Americans neglected to report an estimated $1.5 trillion of income. In Los Angeles county an estimated 28% of the workers are paid in cash; black-market activity may represent as much as 30% of the city's economic activity.

“Reefer Madness” comprises three previously published essays. Each is a deftly woven tale of corruption and desperation. In the title essay Mr Schlosser explores how a country that once required colonists to grow hemp became one of the harshest prosecutors of marijuana offenders in the world, and ponders the myriad social and economic consequences of that transformation.

Mr Schlosser shines a light on the dramatic changes in drug laws over the years. In 1981, for instance, Newt Gingrich introduced a bill to legalise the use of marijuana for medical purposes; 15 years later he sponsored legislation making the punishment for bringing more than two ounces of pot into the country life in prison or the death penalty. In America today—a society Mr Schlosser describes as being “caught in the grip of a deep psychosis”—a person convicted of selling marijuana can be sentenced to more time than a murderer.

Reefer Madness: Sex, Drugs, and Cheap Labor in the American Black Market
By Eric Schlosser

Houghton Mifflin; 320 pages; $23.00. Penguin/Allen Lane; £10.99

Buy it at
Amazon.com

The second essay follows Mr Schlosser's investigations into illegal migrant farmers in California; the third tells the story of America's $10 billion pornography industry. He concludes that there is a connection between the black market and falling personal incomes, a widening gap between rich and poor, and an overall slowdown in the nation's economic development. Mr Schlosser puts forward his thesis with great passion, though to be completely convincing it would need to be argued more thoroughly.

Though less obviously of a piece than “Fast Food Nation”, fans will nevertheless find that Mr Schlosser's telling of the rise and fall of Reuben Sturman, Cleveland's king of porn, is alone worth the price of “Reefer Madness”.

Reefer Madness: Sex, Drugs, and Cheap Labor in the American Black Market.
By Eric Schlosser.
Houghton Mifflin; 320 pages; $23.00. Penguin/Allen Lane; £10.99

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Sudan

And the band plays on

May 8th 2003
From The Economist print edition

TWO new books about Sudan's multiple and recurrent civil wars come to the same depressing conclusion: as long as the northern elite persists in ignoring the south's historic grievances, the much ballyhooed peace process now under way in Machakos, Kenya, stands little chance of lasting success.

Anyone wanting to understand this African tragedy should read Douglas Johnson's “The Root Causes of Sudan's Civil Wars”. An American historian at Oxford University, Mr Johnson offers a brilliant analysis of the war and its causes written in simple, clear prose. Mansour Khalid's “War and Peace in Sudan” is an insider's account of the conflict and the many subsequent peace efforts by a northerner who sympathises with the southern rebels.

The war used to be regarded as a straightforward struggle between Arab north and African south, but the combatants have swelled, both in scope and in number, to take in both the Islamist central government and the rebel Sudan People's Liberation Army (SPLA), as well as a dizzying array of ethnic and tribal militias who like to battle each other as well as the government and the SPLA. At the same time the contest over Sudan's scarce resources has evolved into a fight for control of the south's abundant oil reserves. In the past 20 years, the war has claimed some 2m lives.

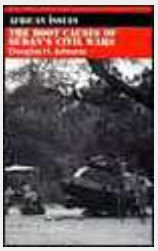
To both Mr Johnson and Mr Khalid, the fact that hostilities have outlasted colonialism as well as the cold war, not to mention many regional reconfigurations, is proof that it has deeper roots than this season's political and economic flashpoints. As far back as the Middle Ages, successive Nile-based rulers established a pattern of plundering Sudan's southern and western hinterlands for slaves. The adoption of Islam by the ruling elite sharpened the divide, with Muslim believers at the centre entitled to protection under *sharia* law and unbelievers on the periphery denied legal rights. Britain compounded the division, first by reinforcing the inequities of development between the centre and outlying regions, and then by hastily granting Sudan independence in 1956 without taking the interests of the southern Sudanese into account.

Two civil wars since then have exacerbated matters. In the north, successive governments have pursued the dream of an Islamic state while arming Arab militias who have resumed slave-raiding in the non-Muslim south. Meanwhile, southern rebel leaders have allowed their movement to fracture along ethnic lines. No northern political leader, writes Mr Khalid (himself a former foreign minister), has had the courage to accept responsibility for the carnage and destruction that the north's policies have wrought. Even today, Sudan's northern leaders cannot see that they can have either an Islamic state or unity with the south—but not both at once.

The government and the SPLA are now in the midst of their first serious peace talks since 1989. Neither Mr Khalid nor Mr Johnson is optimistic. “One amazing feature of the Sudanese conflict is its tenacity,” Mr Khalid notes. “Like the mythical phoenix, whenever the flames of war die down, it surprises friend and foe by emerging from the ashes reinvigorated, more vicious and ready to inflict greater casualties.”

The Root Causes of Sudan's Civil Wars.
By Douglas H. Johnson.
Indiana University Press; 256 pages; $54.95 (hardback) and $24.95 (paperback).

The Root Causes of Sudan's Civil Wars
By Douglas H. Johnson



Indiana University Press; 256 pages; $54.95 (hardback) and $24.95 (paperback).
James Currey; £40 (hardback) and £12.95 (paperback)

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War and Peace in Sudan: A Tale of Two Countries
By Mansour Khalid

Kegan Paul; 568 pages; $144.50

Buy it at
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James Currey; £40 (hardback) and £12.95 (paperback)

War and Peace in Sudan: A Tale of Two Countries.
By Mansour Khalid.
Kegan Paul; 568 pages; $144.50 and £85

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About sponsorship

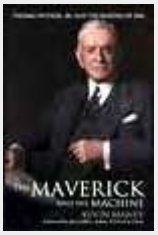
IBM

Punching the card

May 8th 2003
From The Economist print edition

CORPORATE hagiography rings hollow in the current climate of accounting scandals and languishing stock prices. So here is a welcome antidote from a former age: the story of how Thomas Watson turned an obscure vendor of tabulating equipment into the world's largest computer company. Unlikely as it seems, the story is a genuine page-turner, thanks to the unprecedented access that Kevin Maney, a respected technology journalist, was given to IBM's archives.

The Maverick and His Machine: Thomas Watson Sr, and the Making of IBM
By Kevin Maney



John Wiley; 512 pages; $29.95 and £19.99

Buy it at
Amazon.com
Amazon.co.uk

In particular, Mr Maney makes excellent use of transcripts of many of the key meetings in IBM's history, dutifully recorded by company stenographers. There is no need for reconstruction or conjecture here—Mr Maney's book contains vivid passages of actual dialogue as Watson tears into managers, lays out his philosophy and outlines his strategy. Watson is brought to life as a charismatic, irascible and vain man, prone to spouting lengthy sermons, and with a narcissistic weakness for flattery and ceremony. Mr Maney's analysis of the controversy surrounding Watson's acceptance in 1937 of a medal from the Nazi regime is particularly illuminating.

Watson's career was parenthesised by two antitrust suits. He got his start in business working for NCR, a company that sold cash registers. In 1903 he was given the job of setting up a bogus firm, funded by NCR, to monopolise the used cash-register business and thus stifle competition. Watson did a brilliant job, and he was one of several NCR executives later found guilty of anticompetitive practices, though Watson always insisted he was innocent.

AP

Join the dots

Watson then took on the job of running CTR, a company that made tabulating equipment. As he transformed the business into IBM, he imported several aspects of the progressive corporate culture from NCR, such as providing numerous perks to employees, and generous incentives. IBM prospered thanks to the strength of its corporate culture and a fair amount of luck. During the Depression, Watson refused to reduce production or lay off workers. His gamble paid off when President Roosevelt instituted the New Deal, which imposed a large administrative burden on business and boosted demand for IBM's products. By 1952, IBM's stranglehold on the punch-card tabulating business led to Watson's second antitrust suit. Though it was quickly settled at no great cost to the company—its future, by this time, lay in electronic computers—the lawsuit convinced Watson to step aside in favour of his son.

Mr Maney lays to rest an urban myth, revealing that Watson never made his oft-quoted prediction that there was “a world market for maybe five computers”. More importantly, his sympathetic portrait of one of the first great celebrity businessmen provides insight into the changing nature of management techniques, business ethics, corporate culture, and attitudes towards monopolies, all of which should be recommended reading for anyone who seriously wants to be a business mogul.

The Maverick and His Machine: Thomas Watson Sr, and the Making of IBM.
By Kevin Maney.
John Wiley; 512 pages; $29.95 and £19.99

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Crime in the 18th century

Swinging London

May 8th 2003
From The Economist print edition

THERE is a tendency to regard public hangings in the 18th century as some kind of carnival. The handsome highwayman goes cheerily to his death, blowing kisses to the pretty women in the crowd. The rabble shouts encouragement, aware that it is participating in a ritual act designed to re-affirm community bonds. The dreadful deed done, the bad man hanged, the Hogarthian throng of cheerful tradesmen and naughty 'prentice boys return, refreshed and reassured, to their daily grind.

Nothing could be further from the truth, says Peter Linebaugh, in a reissue of his meticulously researched 1991 classic. The author has studied the ghastly sprees of “legal massacre” (Dr Johnson's phrase) that took place in London—at Tyburn, Kennington and Newgate. He links the periodic hunger for public hangings with the ups and downs of trade cycles and corresponding shifts in semi-migrant labour; all too often the gallows became the place where the waste and nuisance products of mercantilism—the hungry, poor and far-from-home—were efficiently dispatched.

“The London Hanged” is intent on commemorating the thousands of virtually anonymous individuals who were hanged in Europe's most violent city during one of its more prosperous centuries. There is Patrick Brown, a spalpeen, or immigrant farm worker from Ireland, who retaliated against his dismissal from the hay harvest in Hampstead in July 1841 by stealing his employer's silver spurs. The gentleman had him hanged, but not until much later, the death being carefully timed so that it would act as a warning to the next season's spalpeens. Then there was Joseph Philip, who stole simply because he was so tired of the periodic famines that were part and parcel of being a silk weaver that “he mightily long'd to die”.

Mr Linebaugh's passionate engagement with *Homo faber*—the making class—of the 18th century bears all the hallmarks of the years he spent working with E.P. Thompson, an eminent socialist historian and anti-nuclear campaigner. Nor does he keep his anger safely in the past, dressed up in breeches and bonnets. In a new introduction, Mr Linebaugh argues that the upsurge in the use of the death penalty since the 1970s is linked to the growth in global capitalism. Just as 18th-century workers found themselves falling foul of rapidly changing definitions of property, rights and labour so, Mr Linebaugh argues, do the mobile work-forces of post-colonial Africa and Asia—exactly those people who are most likely to be executed in the 21st century. Even if you find this implausible, there is no denying the weight and breadth of Mr Linebaugh's research, which puts to shame much recent work on the 18th century. Add the fact that he writes as stylishly as a novelist, and you have a book of rare worth—and one which richly deserves to garner a fresh set of admirers.

The London Hanged: Crime and Civil Society in the Eighteenth Century.
By Peter Linebaugh.
Verso; 492 pages; $20 and £15

The London Hanged: Crime and Civil Society in the Eighteenth Century
By Peter Linebaugh

Verso; 492 pages; $20 and £15

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Far Eastern film

Screen savers

May 8th 2003 | UDINE, ITALY
From The Economist print edition

Women film directors forge ahead in Asia

THE best place to see new Asian films is at the Udine film festival, where the finest works this year were by two young women—a sure sign of how firmly women directors are asserting themselves across the continent.

From China comes a powerful first offering by Ma Xiaoying, who graduated from Beijing's Central Academy of Drama only five years ago. Despite its clumsy title, “Gone Is the One Who Held Me Dearest in the World”, the film is moving without being sentimental. An old woman with senile dementia dies of a long-established cancer. For years she was nursed by a middle-aged daughter, who saw her best years disappear in a slop pail of nappies, forgetfulness and rage. Their fraught relationship is illustrated in a series of vignettes shown in flashbacks that cut directly to a black screen. This is bolder than it sounds. Cinematic convention dictates that sequences should end with a slow fade-out or dissolve into the next scene. In rejecting this, the director shuns the sentimental option and lets the drama speak for itself.

Ms Ma brings the most out of her actors, especially the 83-year-old Huang Suying, who plays the mother, and Siqin Gaowa, who is outstanding as the care-worn daughter. Shrill, shrewish and brusque, she manages at the same time to convey a deeply personal love for the woman who raised her. These emotions are revealed only in minute exchanges of expression, but Ms Ma's camera is poised to capture their every nuance.

Meanwhile, in South Korea, Lee Jeong-hyang treads a similar path. “The Way Home”, her second film, features a seven-year-old Seoul boy dumped for a summer in the country with his deaf, mute grandmother. For him it is purgatory; for her hell. His video game's batteries run down; the chicken on the table is boiled rather than Kentucky-fried. The boy treats his grandmother as a moron and urinates in her shoes for good measure. A self-centred, monstrous kid, and yet the little boy who plays him seems to be having a ball. Ms Lee may be close to 40, but she clearly favours the young.

Against all expectations, this nightmare child slowly learns that other people—even his stupid old grandma—are human and have feelings, too. Ms Lee allows the audience to work this out for themselves, and her film leaves one thinking there may yet be hope for the worst of us. As a piece of didacticism, it is wonderfully peaceable. Profitable too: in South Korea, “The Way Home” has out-grossed “Spiderman” and “The Fellowship of the Ring”.

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New fiction

Breaking waves

May 8th 2003
From The Economist print edition

FANS of Matthew Kneale's “English Passengers” may take similar delight in Joseph O'Connor's kindred work. Both novels are oceanic in every sense. Mr O'Connor has immersed himself deeply in mid-19th century Britain. But where the folly that Mr Kneale explored was the sea voyage itself—to discover the original Garden of Eden—the folly in “Star of the Sea” is the social collapse its passengers flee: the Irish famine.

Technically, this is a crime novel; the victim a Protestant landowner, Lord Kingscourt. The fact that Kingscourt has made extravagant efforts to keep his starving Irish tenants from being cast on to the open road for nonpayment of rent—and is himself being evicted from his estate by creditors—is lost on the militant precursor of the IRA, the Hibernian Defenders. Avenging themselves on callous landlords one and all, they have planted a lowlife to kill Kingscourt on board the *Star of the Sea*, which sets sail from Ireland in the winter of 1847 bound for New York. The vessel carries first-class passengers like Kingscourt and also 300 steerage refugees—emaciated, scabrous emigrants, whose fare is maggoty pork mixed with dirty water.

Mr O'Connor draws on a large population of attendant characters, and even the most minor of them jumps off the page. Full-blown flashbacks keep the novel from growing claustrophobic; while the passengers are stuck with one another on a congested, fetid ship, the reader strolls through scores of pages back on dry land. This is a confident and sumptuously entertaining book, filled with the voice of Mr O'Connor's native Ireland and composed with the sweep of the Atlantic's horizon.

Star of the Sea.
By Joseph O'Connor
Harcourt; 416 pages; $25.
Secker & Warburg; £12.99

Star of the Sea
By Joseph O'Connor

Harcourt; 416 pages; $25.
Secker & Warburg; £12.99

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Walter Sisulu

May 8th 2003
From The Economist print edition

Walter Max Ulyate Sisulu, campaigner for freedom, died on May 5th, aged 90

Reuters

SOMETIMES Walter Sisulu liked to recall the first time he met Nelson Mandela. In 1941, Mr Sisulu was running a small business in Johannesburg, helping blacks to buy and sell their homes, a concession that was later to be withdrawn under apartheid laws. The income from his business helped him to meet the expenses of what he regarded as his main work, as a rising politician. The moment Mr Mandela stepped into Mr Sisulu's office he said he struck him as a potential political leader “more than any person I had met”. It was, he said, “a godsend to me”. Of course, memory does play tricks. But the reality is that the meeting started a collaboration that led 53 years later to Mr Mandela becoming the first president of a democratic South Africa.

Nor did the relationship change in essentials over that long period. Mr Mandela, the son of a chief, tall, easy with people, a natural negotiator; Mr Sisulu, more the policymaker, the wise adviser, even though there were only eight years between them. Not long ago Mr Sisulu told a reporter that Mr Mandela still regarded him as an older brother. Even today, he said, “I know he won't take a decision that affects his life without taking me into his confidence.”

The first decision that Mr Sisulu said Mr Mandela should make was what career to follow. Mr Mandela said he wanted to study law. Mr Sisulu approved, a future African government would need lawyers, and he helped to pay for his law studies. Mr Sisulu's mother gave him a room. A cousin of Mr Sisulu became Mr Mandela's first wife, and he was the best man at their wedding. Eventually Mr Mandela was considered ready to be brought into the African National Congress, where Mr Sisulu was an official. The apprentice leader of a free South Africa moved into position.

His white father

Walter Sisulu's father was a white magistrate, who acknowledged that he was the parent of the boy and that of his sister Rosabella, but played little part in their upbringing. That was left to their mother, Alice, who worked as a maid in white households in Transkei, once a British protectorate (and the home of Mr Mandela's family), now known as the Eastern Cape. Although of mixed race, Mr Sisulu declined to be classified as “coloured” under apartheid laws introduced after the Nationalist Party came to power in 1948.

Coloured people had a number of concessions over blacks; most importantly they did not have to carry

the hated passbooks needed to enter and work in white areas. He said, “I am a black man. I am an African...I never wanted to see my colour determine my race.” He chose to be identified with the Xhosa people, whose language was spoken widely in Transkei. He was happy to be called *umdengentonga*, which translates as “short, but tall when carrying a stick”. He was good at stick fighting, a local sport. But it was his good English, picked up in the white districts where his mother worked, that earned him advantages: he became *picannin* (helper) to the white foreman of a gold mine, and was given the trusted job of lighting the fuse when rock was dynamited.

He joined the African National Congress in his 20s. The congress had been formed in 1912, replacing the more subservient-sounding South African Native National Congress. By the 1940s many in the congress felt that it had become moribund. What was called the “youth league” in the congress in effect took it over and changed its policy from one of passive protest to one of “positive action”. Mr Sisulu, Mr Mandela and Oliver Tambo (who died in 1993) were among the leaders of the takeover.

There followed boycotts, strikes and civil disobedience directed against the ruling white minority. A May Day demonstration in 1950, backed by many non-white organisations, brought to a standstill much of Witwatersrand, in which Johannesburg stands. The police shot dead 18 Africans. The following year, on June 26th, a date that became South Africa's Freedom Day, there were huge demonstrations throughout the country. A “campaign of defiance against unjust laws” followed, as a result of which some 8,000 people of all races were jailed. Mr Sisulu was detained a number of times. He was perhaps the most arrested man in South Africa. With other critics of the government, including Mr Mandela, he was put on trial in 1956 accused of treason.

The trial lasted four years, attracted worldwide attention and at the end all defendants were acquitted. Mr Sisulu and Mr Mandela were arrested again in 1963, again accused of treason, and this time given life sentences. The two men spent the next 26 years in Robben Island prison. Mr Sisulu was set free in October 1989, met by his wife Albertina, his stoic support in and out of prison. Mr Mandela came out four months later. Mr Sisulu said he had no feelings of vengeance, and declined to demonise his enemies. He was in essence a man of gentle character. Thabo Mbeki, South Africa's president, said he once tried to teach Mr Sisulu to drive. But he refused to sound his horn to warn children in the road. Instead, he would stop the car, get out and explain at length that they might get hurt. He never took a driving test, one of the few tests he might have failed.

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Overview

May 8th 2003
From The Economist print edition

Most **stockmarkets** rose over the week. Germany's DAX has gained 36% from its low in March, but is still 63% below its 2000 peak. Britain's FTSE has recovered by a more modest 22% from its low, but that still beats the 15% rise in America's S&P 500 since March.

The bounce in share prices was not supported by better economic news. **America's** unemployment rate rose to 6.0% in April from 5.8% in March; employment in the non-farm sector fell for the third month running. The ISM index of manufacturing activity fell to 45.4, its lowest level since October 2001, when the economy was in recession. Despite all this, the Fed held interest rates steady at 1.25% at its policy meeting on May 6th.

The latest figures from the **euro area** are little better. Unemployment rose to 8.7% of the labour force in March, its highest for more than three years. One of the biggest increases has been in **Germany** where the jobless rate rose to 10.7% in April from 9.6% a year earlier. German retail sales fell by 4% in the year to March. INSEE's second-quarter survey of **French** business showed that confidence had fallen sharply.

The dismal news did not stop investors from pushing the **euro** to its highest rate against the dollar since January 1999—a gain of 36% from its low in 2001. The Canadian dollar rose to a five-year high against the greenback. Sterling fell to within a whisker of a record low against the euro.

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Output, demand and jobs

May 8th 2003
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2003	2004	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 3.0	Q4	+ 1.6	+ 3.0	+ 3.5	+ 2.3	Q4	+ 4.0	Q1	6.1	Apr	6.3
Austria	+ 1.3	Q4	– 0.5	+ 0.9	+ 1.8	– 1.5	Dec	+ 0.9	Dec	4.3	Mar	4.0
Belgium	+ 1.7	Q4	+ 1.2	+ 1.1	+ 2.1	– 1.6	Feb	– 5.3	Feb	11.6	Apr†	10.5
Britain	+ 2.3	Q1	+ 0.7	+ 1.8	+ 2.4	+ 0.1	Feb	+ 4.3	Mar	5.1	Feb††	5.1
Canada	+ 3.9	Q4	+ 1.6	+ 2.7	+ 3.2	+ 1.9	Feb	– 0.2	Jan	7.3	Mar	7.7
Denmark	+ 0.9	Q4	– 0.1	+ 1.5	+ 2.2	– 1.6	Mar	+ 5.8	Feb	5.7	Feb	5.0
France	+ 1.5	Q4	– 0.3	+ 1.2	+ 2.1	+ 2.0	Feb	– 0.8	Feb	9.3	Mar	8.9
Germany	+ 0.5	Q4	– 0.1	+ 0.4	+ 1.5	+ 0.2	Feb	– 4.0	Mar	10.7	Apr§	9.6
Italy	+ 1.0	Q4	+ 1.7	+ 1.0	+ 1.9	– 1.2	Feb	+ 0.8	Feb†	9.0	Jan	9.0
Japan	+ 2.8	Q4	+ 2.2	+ 0.7	+ 0.8	+ 3.8	Mar	– 0.2	Feb	5.4	Mar	5.3
Netherlands	+ 0.4	Q4	– 0.4	+ 0.5	+ 1.6	– 1.6	Feb	– 2.5	Dec	4.9	Mar**	3.7
Spain	+ 2.1	Q4	+ 1.4	+ 2.1	+ 2.6	+ 9.5	Mar	+ 2.3	Feb	11.5	Mar	11.2
Sweden	+ 1.3	Q4	+ 1.2	+ 1.5	+ 2.3	– 1.8	Feb	+ 2.6	Mar	4.6	Mar†	3.8
Switzerland	+ 0.8	Q4	+ 1.4	+ 0.8	+ 1.6	– 2.1	Q4	– 1.3	Jan	3.9	Apr†	2.5
United States	+ 2.1	Q1	+ 1.6	+ 2.2	+ 3.2	+ 0.4	Mar	+ 4.6	Mar	6.0	Apr	5.9
Euro area	+ 1.3	Q4	+ 0.7	+ 1.1	+ 2.1	+ 1.8	Feb	+ 0.7	Feb	8.7	Mar	8.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.8	Q4	+ 2.8	na	na	– 2.0	Mar	+ 5.1	Jan	9.9	Mar†	9.5
Greece	+ 3.5	Q4	na	na	na	+ 0.7	Feb	na		na		na
Iceland	– 3.0	Q4	na	na	na	– 0.3	2002	na		4.0	Mar†	2.7
Ireland	+ 6.4	Q4	na	na	na	+14.3	Feb	– 2.0	Feb	4.6	Apr†	4.2
Luxembourg	+ 1.0	2001	na	na	na	+ 3.1	Jan	+ 9.7	Dec	3.7	Mar	2.8
New Zealand	+ 4.2	Q4	+ 2.0	na	na	+ 5.9	Q4	+ 7.3	Q4	4.9	Q4	5.4
Norway	– 0.1	Q4	+ 0.9	na	na	– 6.0	Feb	+ 0.9	Mar	4.4	Q1	4.1
Portugal	– 1.3	Q4	– 3.1	na	na	+ 3.4	Feb	+ 2.3	Feb	6.2	Q4†	4.2

*% change at an annual rate. †Not seasonally adjusted. ‡New series. ††Dec-Feb; claimant count rate 3.1% in Mar. §EU harmonised rate 9.4% in April. **Jan-Mar, new series.

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Prices and wages

May 8th 2003
From The Economist print edition

% change on year ago

	Consumer prices		The Economist poll consumer prices forecast		Producer prices		Wages/earnings	
	latest	year ago	2003	2004	latest	year ago	latest	year ago
Australia	+ 3.4 Q1	+ 2.9	+ 2.7	+ 2.5	+ 3.0 Q1	+ 0.5	+ 3.9 Q4	+ 4.9
Austria	+ 1.8 Mar	+ 1.9	+ 1.5	+ 1.3	+ 0.8 Apr	− 0.5	+ 2.2 Mar	+ 2.4
Belgium	+ 1.5 Apr	+ 1.8	+ 1.4	+ 1.4	+ 0.8 Mar	− 0.9	+ 2.4 Q1	+ 3.1
Britain	+ 3.1 Mar	+ 1.3	+ 2.8	+ 2.4	+ 1.9 Mar	− 0.1	+ 3.0 Feb	+ 2.6
Canada	+ 4.3 Mar	+ 1.8	+ 3.1	+ 2.2	+ 1.3 Mar	− 1.0	+ 2.1 Feb	+ 3.5
Denmark	+ 2.9 Mar	+ 2.6	+ 2.3	+ 1.9	+ 0.7 Mar	+ 0.8	+ 3.9 Q4	+ 4.1
France	+ 2.6 Mar	+ 2.1	+ 1.8	+ 1.4	+ 2.5 Mar	− 0.8	+ 3.5 Q4	+ 3.9
Germany	+ 1.1 Apr	+ 1.5	+ 1.1	+ 0.9	+ 1.3 Mar	nil	+ 2.6 Feb	+ 2.5
Italy	+ 2.7 Apr	+ 2.3	+ 2.3	+ 1.9	+ 2.8 Mar	− 0.8	+ 1.7 Mar*	+ 2.1
Japan	− 0.1 Mar	− 1.2	− 0.6	− 0.5	− 0.7 Mar	− 2.5	+ 2.5 Mar	− 0.9
Netherlands	+ 2.7 Mar	+ 3.7	+ 2.5	+ 2.1	+ 3.5 Mar	− 1.7	+ 2.8 Mar	+ 4.4
Spain	+ 3.7 Mar	+ 3.2	+ 3.0	+ 2.6	+ 3.0 Mar	− 0.1	+ 3.9 Q4	+ 3.7
Sweden	+ 3.1 Mar	+ 2.9	+ 2.4	+ 1.8	+ 0.6 Mar	− 0.4	+ 2.1 Feb	+ 3.3
Switzerland	+ 0.7 Apr	+ 1.1	+ 0.8	+ 0.9	+ 0.3 Mar	− 1.3	+ 1.8 2002	+ 2.5
United States	+ 3.0 Mar	+ 1.5	+ 2.3	+ 1.7	+ 4.2 Mar	− 1.6	+ 3.1 Apr	+ 3.2
Euro area	+ 2.1 Apr	+ 2.3	+ 1.9	+ 1.5	+ 2.4 Mar	− 0.8	+ 3.4 Q4	+ 3.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 1.6 Mar	+ 1.8	na	na	+ 0.8 Mar	− 0.8	+ 3.3 Q4	+ 4.5
Greece	+ 4.1 Mar	+ 4.0	na	na	+ 2.0 Mar	+ 4.2	na	na
Iceland	+ 2.3 Apr	+ 7.5	na	na	+ 3.3 Apr	+ 8.7	+ 5.7 Mar	+ 8.7
Ireland	+ 4.9 Mar	+ 4.8	na	na	− 7.1 Mar	+ 0.7	+ 6.8 Q4	+ 7.8
Luxembourg	+ 2.7 Mar	+ 2.1	na	na	+ 2.3 Feb	− 2.4	− 1.4 Jan	+ 1.9
New Zealand	+ 2.5 Q1	+ 2.6	na	na	− 0.9 Q4	+ 1.8	+ 2.3 Q1	+ 2.1
Norway	+ 3.7 Mar	+ 1.0	na	na	+ 5.1 Mar	− 4.5	+ 5.2 Q4	+ 4.4
Portugal	+ 3.9 Mar	+ 3.2	na	na	+ 2.1 Mar	− 0.4	+ 0.4 Jan	+ 1.3

*New series.

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Economic forecasts

May 8th 2003
From The Economist print edition

The Economist poll of forecasters, May averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2003	2004	2003	2004	2003	2004	2003	2004
Australia	2.7/3.3	2.7/4.4	3.0	3.5 (3.6)	2.7	2.5	-4.7	-4.0 (-3.9)
Austria	0.5/1.1	1.2/2.3	0.9 (1.0)	1.8 (1.9)	1.5 (1.7)	1.3	-0.1(-0.7)	-0.2 (-0.9)
Belgium	0.6/1.5	1.3/2.4	1.1 (1.2)	2.1 (2.2)	1.4 (1.5)	1.4	5.0 (4.9)	5.0 (4.9)
Britain	1.4/2.4	2.0/3.0	1.8 (1.9)	2.4 (2.5)	2.8	2.4 (2.5)	-1.6(-1.8)	-1.4 (-1.6)
Canada	2.2/3.4	2.7/4.0	2.7 (2.8)	3.2 (3.3)	3.1 (3.0)	2.2	1.5 (1.6)	1.6 (1.7)
Denmark	0.9/2.1	1.1/2.5	1.5	2.2 (2.3)	2.3	1.9 (2.0)	2.3 (2.0)	2.2 (1.9)
France	0.7/1.5	0.9/2.5	1.2	2.1 (2.3)	1.8 (1.7)	1.4	1.8 (1.7)	1.5 (1.6)
Germany	-0.1/0.7	0.6/2.2	0.4	1.5 (1.6)	1.1	0.9 (1.0)	1.9	1.6 (1.8)
Italy	0.6/1.6	0.8/2.5	1.0	1.9 (2.0)	2.3	1.9	-0.3(-0.4)	-0.3
Japan	0.0/1.5	0.0/2.0	0.7	0.8	-0.6	-0.5	2.7 (2.6)	2.9
Netherlands	-0.2/0.8	0.8/2.0	0.5 (0.6)	1.6 (1.9)	2.5 (2.6)	2.1	3.1 (3.2)	3.1 (3.2)
Spain	1.8/2.5	2.1/3.3	2.1	2.6 (2.7)	3.0	2.6	-2.2	-2.1
Sweden	1.3/1.7	1.6/2.8	1.5 (1.7)	2.3 (2.4)	2.4	1.8 (2.0)	3.6	3.5
Switzerland	0.5/1.2	0.7/2.3	0.8	1.6 (1.8)	0.8 (0.7)	0.9	11.7(11.2)	11.7 (11.4)
United States	1.3/2.8	1.7/4.5	2.2	3.2 (3.3)	2.3	1.7 (1.8)	-5.3(-5.4)	-5.4 (-5.3)
Euro area	0.7/3.5	0.9/4.1	1.1 (1.0)	2.1	1.9 (1.8)	1.5	0.8	0.7 (0.8)

Sources: ABN Amro, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, Merrill Lynch, J.P. Morgan Chase, Morgan Stanley, Nordea, Decision Economics, BNP Paribas, Royal Bank of Canada, Schroder Salomon Smith Barney, Scotiabank, UBS Warburg

Every month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances for 15 countries and for the euro area. The table also shows the highest and lowest projections for growth. The previous month's forecasts, where different, are shown in brackets. The panel has trimmed its growth predictions for next year in most countries. It now expects America's economy to grow by 3.2% in 2004, down from 3.3% in April. The German economy is forecast to grow by 1.5%, down from 1.6% last month. The panel has cut its forecasts for British economic growth in both 2003 and 2004, to 1.8% and 2.4%, respectively, but Britain's economy is still expected to experience faster growth than the euro area's in both years. Australia's GDP is expected to rise by a roaring 3.5% in 2004.

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Money and interest rates

May 8th 2003
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (May 7th 2003)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	–10.0	+10.6	Mar	4.77	4.77	4.49	5.13	6.12	5.91
Britain	+ 6.3	+ 7.3	Mar	3.56	4.06	3.35	4.25	5.20	5.83
Canada	+ 7.0	+ 4.9	Mar	3.19	2.46	3.56	4.90	5.66	6.70
Denmark	+ 8.2	+ 9.2	Mar	2.70	3.70	2.50	4.17	5.33	5.37
Japan	+14.4	+ 1.8	Mar	0.02	0.03	0.05	0.60	1.36	0.72
Sweden	+ 2.2	+ 5.9	Mar	3.43	4.31	3.36	4.45	5.61	3.85
Switzerland	+24.0	+10.0	Mar	0.29	1.28	0.41	2.39	3.28	3.28
United States	+ 4.0	+ 6.4	Mar	1.16	1.82	1.40	3.69	5.21	5.47
Euro area†	+11.6	+ 7.9	Mar	2.48	3.42	2.32	3.93	5.09	4.07

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.69%, Japan No.248 0.60%. Central bank rates: US fed funds 1.25%, ECB refinancing 2.50%, BOJ overnight call 0.001%, BOE repo 3.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

May 8th 2003
From The Economist print edition

1995=100

	Apr 29th	May 6th*	% change on one month	% change on one year
Dollar index				
All items	75.6	75.5	– 0.4	+11.0
Food	78.2	78.0	+ 0.2	+15.7
Industrials				
All	72.1	71.9	– 1.3	+ 4.7
Nfa†	75.6	74.3	– 5.0	+ 7.1
Metals	69.3	70.0	+ 2.3	+ 2.7
Sterling index				
All items	75.0	73.7	– 4.4	+ 0.7
Euro index				
All items	90.3	87.5	– 6.3	–10.7
Yen index				
All items	96.7	94.7	– 2.1	+ 2.3
Gold				
$ per oz	334.05	342.90	+ 6.2	+ 9.8
West Texas Intermediate				
$ per barrel	25.24	25.73	– 8.2	– 4.6

* Provisional. † Non-food agriculturals.

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Stockmarkets

May 8th 2003
From The Economist print edition

Market indices

	May 7th	2003 high	2003 low	% change on one week	% change on record high	% change on Dec 31st 2002 in local currency	% change on Dec 31st 2002 in $ terms
Australia (All Ordinaries)	2,944.2	3,049.6	2,673.3	- 0.9	-14.4	- 1.1	+11.7
Austria (ATX)	1,298.7	1,298.7	1,120.2	+ 5.7	-25.2	+12.9	+22.2
Belgium (Bel 20)	1,940.4	2,074.1	1,426.6	+ 3.7	-47.3	- 4.2	+ 3.7
Britain (FTSE 100)	3,992.9	4,009.5	3,287.0	+ 1.7	-42.4	+ 1.3	+ 0.2
Canada (Toronto Composite)	6,650.6	6,837.3	6,228.6	+ 1.0	-41.6	+ 0.5	+13.3
Denmark (KBX)	175.9	177.8	145.0	- 0.1	-41.7	+ 5.8	+14.5
France (SBF 250)	2,036.3	2,144.8	1,630.1	+ 2.5	-53.6	- 0.8	+ 7.3
(CAC 40)	3,024.0	3,210.3	2,403.0	+ 2.4	-56.3	- 1.3	+ 6.8
Germany (DAX)	3,005.6	3,157.3	2,203.0	+ 2.2	-62.7	+ 3.9	+12.4
Italy (BCI)	1,131.9	1,142.4	959.4	+ 1.7	-48.1	+ 3.7	+12.2
Japan (Nikkei 225)	8,109.8	8,790.9	7,607.9	+ 3.6	-79.2	- 5.5	- 3.6
(Topix)	822.9	865.4	770.6	+ 3.3	-71.5	- 2.4	- 0.5
Netherlands (AEX)	285.8	337.3	218.4	+ 1.1	-59.3	-11.4	- 4.1
Spain (Madrid SE)	671.3	684.6	576.8	- 0.6	-41.4	+ 5.9	+14.6
Sweden (Affarsvarlden Gen)	149.9	153.4	127.8	- 0.4	-62.6	+ 3.2	+12.3
Switzerland (Swiss Market)	4,630.5	4,965.3	3,675.4	+ 1.9	-45.0	- 0.0	+ 4.2
United States (DJIA)	8,560.6	8,842.6	7,524.1	+ 0.9	-27.0	+ 2.6	+ 2.6
(S&P 500)	929.6	934.4	800.7	+ 1.4	-39.1	+ 5.7	+ 5.7
(NASDAQ Comp)	1,506.8	1,523.7	1,271.5	+ 2.9	-70.2	+12.8	+12.8
Europe (FTSE Eurotop 300)*	828.4	890.8	682.7	+ 0.9	-51.4	- 3.3	+ 4.6
Euro area (FTSE Ebloc 100)*	709.6	757.2	565.7	+ 1.5	-54.2	- 1.2	+ 6.9
World (MSCI)†	830.7	834.8	710.8	+ 2.1	-42.7	na	+ 4.9
World bond market (Citigroup)‡	559.4	565.2	518.6	+ 2.1	+ 0.8	na	+ 6.5

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

May 8th 2003
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current account $bn latest 12 mths		Current account The Economist poll % of GDP, forecast 2003	Current account The Economist poll % of GDP, forecast 2004	Exchange rate trade-weighted† 1990=100 May 7th	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ May 7th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2003‡
Australia	− 7.8	Mar	− 17.7	Q4	− 4.7	− 4.0	79.8	76.0	1.57	1.85	2.50	1.79	1.35	0.2
Austria	+ 0.6	Jan	+ 1.4	Feb	− 0.1	− 0.2	101.7§	100.3	0.88	1.10	1.40	–	0.76	-1.3
Belgium	+ 17.4	Feb	+ 11.8	Dec	+ 5.0	+ 5.0	101.4§	99.3	0.88	1.10	1.40	–	0.76	nil
Britain	− 55.5	Feb	− 13.1	Q4	− 1.6	− 1.4	97.3	106.2	0.63	0.69	–	0.71	0.54	-1.9
Canada	+ 35.0	Feb	+ 11.0	Q4	+ 1.5	+ 1.6	83.4	76.5	1.40	1.57	2.23	1.59	1.21	1.1
Denmark	+ 8.6	Feb	+ 5.6	Feb	+ 2.3	+ 2.2	106.2	102.4	6.54	8.18	10.4	7.43	5.62	1.6
France	+ 8.9	Feb	+ 28.3	Feb	+ 1.8	+ 1.5	104.5§	101.6	0.88	1.10	1.40	–	0.76	-3.6
Germany	+122.8	Feb	+ 47.1	Feb	+ 1.9	+ 1.6	101.8§	98.5	0.88	1.10	1.40	–	0.76	-3.7
Italy	+ 7.5	Feb	− 9.6	Feb	− 0.3	− 0.3	74.5§	72.5	0.88	1.10	1.40	–	0.76	-2.4
Japan	+ 95.9	Feb	+115.0	Feb	+ 2.7	+ 2.9	131.4	130.0	116	129	185	132	–	-7.7
Netherlands	+ 29.5	Feb	+ 9.1	Q4	+ 3.1	+ 3.1	100.7§	97.9	0.88	1.10	1.40	–	0.76	-1.6
Spain	− 40.8	Jan	− 17.4	Jan	− 2.2	− 2.1	76.0§	74.2	0.88	1.10	1.40	–	0.76	-0.4
Sweden	+ 15.2	Mar	+ 9.9	Dec	+ 3.6	+ 3.5	81.0	75.2	8.01	10.2	12.8	9.10	6.89	0.7
Switzerland	+ 4.8	Mar	+ 32.0	Q4	+11.7	+11.7	114.7	113.9	1.33	1.60	2.11	1.51	1.14	na
United States	−503.7	Feb	−503.4	Q4	− 5.3	− 5.4	103.8	120.0	–	–	1.59	1.14	0.86	-4.6
Euro area	+ 95.6	Feb	+ 53.1	Feb	+ 0.8	+ 0.7	89.9	79.4	0.88	1.10	1.40	–	0.76	-2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 13.5	Feb	+ 10.1	Feb	na	na	80.4§	78.2	0.88	1.10	1.40	–	0.76	3.1
Greece	− 22.3	Feb	− 10.8	Feb	na	na	58.7§	57.5	0.88	1.10	1.40	–	0.76	-1.0
Iceland	+ 0.2	Mar	nil	Q4	na	na	93.0**	80.4	73.7	91.8	117	83.7	63.4	nil
Ireland	+ 36.3	Feb	− 0.2	Q4	na	na	91.6§	87.2	0.88	1.10	1.40	–	0.76	-0.8
Luxembourg	− 3.0	Jan	+ 1.7	Q4	na	na	101.4§	99.3	0.88	1.10	1.40	–	0.76	0.2
New Zealand	− 0.9	Mar	− 1.9	Q4	na	na	96.3	85.8	1.77	2.22	2.82	2.01	1.52	0.8
Norway	+ 28.1	Mar	+ 28.1	Feb	na	na	102.1	101.6	6.92	8.35	11.0	7.86	5.95	11.3
Portugal	− 12.6	Jan	− 8.8	Feb	na	na	91.3**	89.9	0.88	1.10	1.40	–	0.76	-3.2

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, January average. ‡OECD forecast. **IMF, November average.

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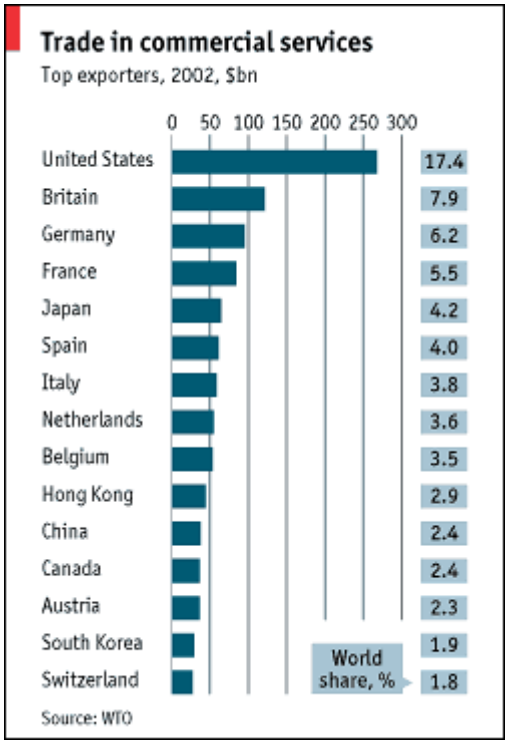
Trade in commercial services

May 8th 2003
From The Economist print edition



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Overview

May 8th 2003
From The Economist print edition

Consumer prices in **Argentina** rose by a mere 0.1% in April; the government now reckons that inflation for 2003 will run at 8%, down from an earlier estimate of 22%. In 2002, by comparison, consumer prices rose by 41%.

In **Chile**, which already has some of the lowest consumer-price inflation in Latin America, 12-month inflation fell yet further in April to 4.0%, down from 4.5% in March.

Malaysia's trade surplus rose to $1.7 billion in March, up from $1.3 billion in February, as exports far outstrip economists' forecasts.

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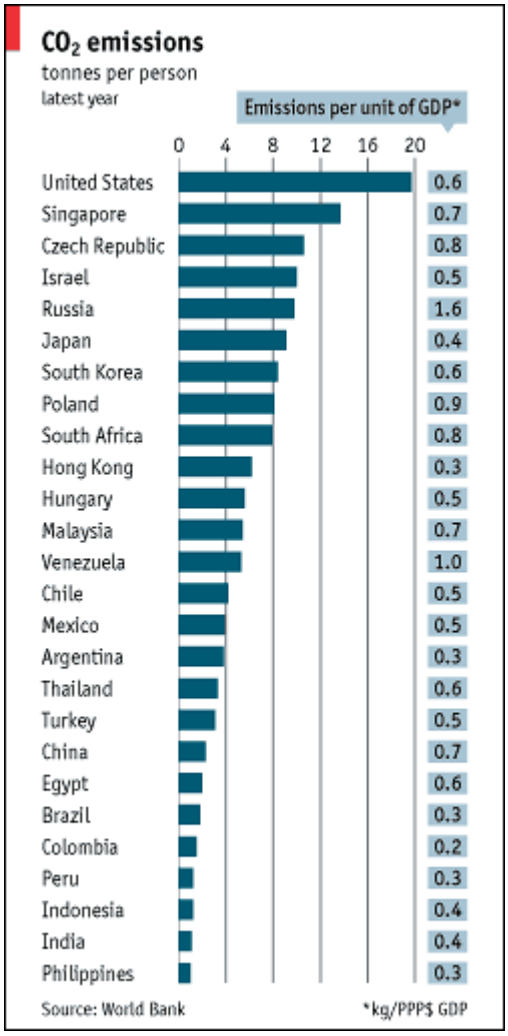
CO_2 emissions

May 8th 2003
From The Economist print edition

Rich countries consume a disproportionate amount of energy and natural resources, says a new World Bank publication, the Little Green Data Book 2003. The report details various environmental indicators for countries, regions and income groups. It points out that the 15% or so of the world's population living in high-income countries are responsible for half of the carbon dioxide (the principal greenhouse gas behind global warming) released by man-made sources. That is partly because the rich world also generates much of the world's economic activity. America, for example, uses 16 times as much energy per person as India.



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Economy

May 8th 2003
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.9	Q1	+16.9	Mar	+ 0.9	Mar	+22.1	Mar	+33.5	2002†	312.9	Feb
Hong Kong	+ 5.0	Q4	– 9.2	Q4	– 2.1	Mar	– 8.0	Mar	+13.8	Q4	114.2	Apr
India	+ 2.6	Q4	+ 6.4	Feb	+ 4.1	Mar	– 9.0	Mar	+ 4.8	Q4	71.1	Mar
Indonesia	+ 3.8	Q4	+ 6.7	Jan	+ 7.5	Apr	+25.6	Mar	+ 7.5	Q3	31.6	Mar
Malaysia	+ 5.6	Q4	+ 5.0	Mar	+ 0.7	Mar	+14.7	Mar	+ 7.3	Q4	33.8	Mar
Philippines	+ 5.8	Q4	+ 4.9	Jan	+ 2.8	Apr	+ 0.2	Feb	+ 6.1	Sep	13.1	Apr
Singapore	+ 1.5	Q1	+ 6.5	Mar	+ 0.8	Mar	+11.1	Mar	+18.7	Q4	83.4	Apr
South Korea	+ 6.8	Q4	+ 4.5	Mar	+ 3.7	Apr	+ 8.0	Apr	+ 2.9	Mar	123.8	Mar
Taiwan	+ 4.2	Q4	+ 1.6	Mar	– 0.1	Apr	+16.6	Mar	+25.8	Q4	168.6	Mar
Thailand	+ 6.1	Q4	+12.7	Mar	+ 1.6	Apr	+ 3.9	Mar	+ 8.5	Mar	36.8	Mar
Argentina	– 3.6	Q4	+15.8	Mar	+19.4	Apr	+16.7	Mar	+ 8.9	Q4	11.0	Apr
Brazil	+ 3.4	Q4	+ 4.1	Feb	+16.7	Mar	+17.1	Apr	– 4.4	Mar	42.3	Mar
Chile	+ 3.2	Q4	+ 6.9	Mar	+ 4.0	Apr	+ 2.5	Mar	– 0.6	Q4	16.1	Mar
Colombia	+ 2.0	Q4	+ 5.0	Feb	+ 7.6	Mar	nil	Dec	– 1.6	Q4	10.5	Mar
Mexico	+ 1.9	Q4	+ 1.2	Feb	+ 5.6	Mar	– 6.7	Mar	–14.5	Q4	53.7	Apr
Peru	+ 5.3	Feb	+ 4.2	Feb	+ 3.4	Mar	+ 0.4	Feb	– 1.1	Q4	9.8	Mar
Venezuela	–16.7	Q4	–64.8	Dec	+34.1	Mar	+13.9	Q4	+ 7.6	Q4	8.4	Feb
Egypt	+ 3.1	2002†	+ 4.2	2002†	+ 3.1	Feb	– 7.4	Jan	+ 0.5	Q4	13.2	Dec
Israel	+ 1.3	Q4	+ 3.0	Jan	+ 4.8	Mar	– 5.7	Mar	– 2.1	Q4	23.4	Apr
South Africa	+ 3.0	Q4	+ 0.4	Feb	+12.5	Mar	+ 3.6	Mar	+ 0.3	Q4	6.1	Mar
Turkey	+11.4	Q4	+ 4.4	Feb	+29.4	Mar	–16.4	Feb	– 2.7	Feb	27.9	Feb
Czech Republic	+ 1.5	Q4	+ 5.2	Feb	– 0.4	Mar	– 2.6	Mar	– 3.5	Q4	24.7	Mar
Hungary	+ 3.7	Q4	+ 1.6	Feb	+ 4.7	Mar	– 3.6	Feb	– 3.0	Feb	13.6	Mar
Poland	+ 2.1	Q4	+ 5.7	Mar	+ 0.6	Mar	– 9.9	Mar	– 5.8	Mar	30.0	Mar
Russia	+ 5.2	Q4	+ 6.7	Mar	+14.6	Apr	+50.2	Feb	+38.3	Q1	51.8	Mar
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.6	2002†	+15.8	Nov	+ 2.3	Mar	– 1.5	Apr	+ 2.7	2002†	10.3	Mar
Saudi Arabia	+ 1.2	2001	na		– 0.9	Jan	+39.2	2001	+ 9.4	2001	21.2	Jan

*Excluding gold, except Singapore; IMF definition. †EIU est. †Year ending June. ‡New series.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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Financial markets

May 8th 2003
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	May 7th		Dec 31st 2002	
	May 7th	year ago	May 7th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	13.2	na	1,592.2§	nil	+ 12.2	+ 12.2
Hong Kong	7.80	7.80	12.4	1.41	8,901.1	+2.1	– 4.5	– 4.5
India	47.2	48.9	75.2	4.94	2,980.7	+0.7	– 11.7	– 10.4
Indonesia	8,503	9,290	13,536	11.51	473.1	+4.9	+ 11.3	+ 17.2
Malaysia	3.80	3.80	6.05	3.10	632.3	+0.3	– 2.2	– 2.2
Philippines	52.0	49.8	82.7	9.13	1,077.9	+0.9	+ 5.8	+ 8.7
Singapore	1.74	1.81	2.77	0.63	1,307.5	+2.0	– 2.5	– 2.7
South Korea	1,199	1,280	1,908	5.51	618.1	+3.1	– 1.5	– 2.6
Taiwan	34.7	34.5	55.2	1.35	4,275.9	+3.1	– 4.0	– 3.6
Thailand	42.5	42.9	67.6	1.75	379.5	+1.3	+ 6.4	+ 8.0
Argentina	2.81	3.20	4.47	6.60	639.9	+0.6	+ 21.9	+ 46.1
Brazil	2.97	2.43	4.73	26.32	12,956.2	+3.2	+ 15.0	+ 36.9
Chile	694	653	1,106	2.52	5,705.3	+0.5	+ 13.7	+ 17.9
Colombia	2,865	2,285	4,561	7.71	1,751.7	+1.7	+ 8.9	+ 9.0
Mexico	10.20	9.42	16.2	5.82	6,575.3	+1.0	+ 7.3	+ 10.0
Peru	3.47	3.43	5.53	3.81	1,780.6	+0.7	+ 27.9	+ 29.5
Venezuela	1,598	924	2,544	23.04	8,551.1	–0.9	+ 6.7	– 7.4
Egypt	5.96	4.60	9.48	12.29	7,467.7	+4.8	+ 39.0	+ 8.1
Israel	4.45	4.90	7.09	5.82	409.3**	+4.2	+ 23.1	+ 31.4
South Africa	7.3	10.3	11.6	13.75	7,685.5	+2.3	– 17.2	– 2.6
Turkey	1,534,000	1,377,500	2,442,128	39.00	10,676.3	–7.2	+ 3.0	+ 11.4
Czech Republic	27.6	33.5	44.0	2.47	539.6	+3.6	+ 17.1	+ 27.4
Hungary	216	268	344	6.50	8,216.1	+0.6	+ 5.4	+ 9.8
Poland	3.80	3.99	6.05	5.63	14,503.7	+1.7	+ 1.0	+ 1.8
Russia	31.1	31.2	49.5	18.00	423.2‡	+0.2	+ 14.7	+ 17.9
EMF (MSCI)*	1.00	1.00	1.59	na	302.2	+2.4	na	+ 3.5
EMBI+†	1.00	1.00	1.59	na	266.2	+1.8	na	+ 16.3

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡ In $ terms. §April 30th. **May 5th.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

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